Capitalism and Its Discontents

Critical Review

An Interdisciplinary Journal *of* Politics *and* Society

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David R. Henderson

HOW (SOME) SOCIALISTS BECOME CAPITALISTS: THE CASES OF THREE PROMINENT INTELLECTUALS

ABSTRACT: *Three prominent economists born early in the twentieth century—James Buchanan, Jack Hirshleifer, and Simon Rottenberg—switched from a belief in socialism in their twenties or thirties to strong support for free markets. Interviews show that for all three, and especially for Buchanan and Rottenberg, what changed them is what they learned in their economics classes. For Hirshleifer, another major influence was the pact between Hitler and Stalin, which caused him to be more skeptical about leftist ideas and made him more open to intellectual criticisms of socialism.*

Before they became free-marketeers, many of today's most prominent economists would have been horrified at the idea of such a "conversion." They believed, essentially, that capitalism was evil: a system that, fueled by greed, brought poverty and suffering to the many. Detailed interviews with free-market economists discloses not only that they were often far to the left originally, but that they have in common similar reasons for abandoning their original worldviews.

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Good-Hearted Socialists

In the 1930s, during and after the Great Depression, the vast majority of U.S. intellectuals were or became socialists. This was especially true of Jewish intellectuals, many of whom formed the intellectual core of the U.S. Communist Party, and was even more true of Jewish intellectuals in and around New York. In a recent interview, UCLA economist Jack Hirshleifer, who, in 1925, was born into a Jewish family in Brooklyn, put it as follows:

> In this particular period [the late 1930s and early 1940s], New York Jewish intellectuals were all socialists. If you were a good-hearted person and you were an intellectual, you were a socialist. There were many people who were not socialist because [pause] they were just not interested in intellectual matters, or they were cynical, didn't have good hearts [laughs], and the like. But the idea that there might be some *intellectual* objection to socialism [shakes his head]—I don't think I ever encountered that. It just never crossed my path, intellectually speaking, in spite of very broad and miscellaneous reading on my part. . . . I genuinely never, ever encountered anything that would run opposite to the trend of the time. (Henderson 1998c, 8:00)

Hirshleifer, who became an intellectual very early in his life, became at the same time a committed socialist. He read widely on socialism as well as other topics, and was quite familiar with socialist literature by age 14.

A second prominent free-market economist, Simon Rottenberg, had a somewhat similar experience. His father was, in Rottenberg's words, a "right-wing socialist," that is, a socialist who rejected Soviet totalitarianism because the USSR's government was antidemocratic and suppressed freedom of speech and other traditional civil liberties. Rottenberg, who was born in 1916, joined the Young People's Socialist League while working as a messenger in the U.S. Department of Agriculture between 1934 and 1937.

> I was a member of the Young People's Socialist League in Washington. . . . [My father] was critical of me because I was a member of the Young People's Socialist League at a time when the Socialist Party, with which the Young People's Socialist League was affiliated, was, in fact, engaging in alliances with the Communist Party. (Henderson 1999b, 2:00)

The winner of the 1986 Nobel prize in economic science, James M. Buchanan, came to his socialism from a very different background.

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Born in 1919, Buchanan grew up on a farm in rural Tennessee. His grandfather, James Buchanan, had been a populist Tennessee politician in the nineteenth century. Says Buchanan:

> My grandfather was governor of Tennessee on this populist ticket. At that time, that was anti-the Wall Street barons, anti-the rich. And I read all these pamphlets in the old house I grew up in. That was my main reading as a kid—all these propaganda pamphlets. You can't say they don't have influence on you. They do. (Henderson 1998a, 30:00)

In 1940, Buchanan earned an undergraduate degree from Middle Tennessee State Teachers College; by 1941, he also had a master's degree in economics from the University of Tennessee (Buchanan 1997, 181). Although he considered himself an economist, by his own admission he had not really learned much economics. He writes:

> By the academic counters, I took courses labeled "economics," and I made good grades. But as I have noted, however, I learned little or no economics in my preferred definition during that Knoxville year. I surveyed the workings and structures of the institutions of Roosevelt's New Deal; I came to understand central banking theory and policy; I learned something about taxation and budgeting processes; I learned a bit of elementary statistics, especially in practice. But neither in these courses nor in my prior undergraduate experience did I have proper exposure to the central principle of market organization. I remained blissfully ignorant of the coordinating properties of a decentralized market process. (Buchanan 1992, 167)

In August 1941, four months before Pearl Harbor, Buchanan was drafted into the U.S. Navy (Buchanan 1992, 3). He recounts that he

> came into the Navy from this Tennessee background, with, I think, a lot of my generation, with sort of a mild socialistic view of the world, I guess a social democrat view of the world, populist background. (Henderson 1998a, 4:00)

Buchanan explains that this worldview was "not so much pro-government as it was anti-big business, anti-Wall Street, anti-the tycoons, anti-the Rockefellers, anti-the rich" (ibid.).

Direct experience with one of the Rockefellers strongly buttressed Buchanan's anti-rich tendencies. As Buchanan put it:

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> I had those prejudices strongly reinforced in naval training school, officer training school in New York. . . . After we had been there a few weeks and done boot-camp kind of stuff, they selected cadet officers—midshipman officers, they called them. And despite the fact that most of us were from the South and West, and only a few of us from the Eastern establishment schools, they picked 11 out of 12 of the midshipman officers from Yale, Princeton, or Harvard. That was clear overt prejudice against the rest of us. . . . They divided us by alphabet and I was in the company where they had the As and Bs and Cs. There happened to be no Eastern establishment boys in that particular alphabet and there were lots of them down in the Rs and Ts and Ss. And so they actually imported Bill Rockefeller to be the head of our company because we didn't have one from the right background. . . . I think it was Nelson's first cousin. . . . He turned out to be a fine fellow. But it was just the prejudice of putting them in. I didn't know anything about statistical discrimination, and it made some sense, from their point of view, to pick someone from Yale would on average be better than someone from Middle Tennessee. But on the other hand that came home to us as control by the Eastern establishment, and that reinforced my prejudices. (Henderson 1998a, 4:30)

All three of these future free-marketeers started out as anticapitalists of various types. What changed their minds?

Shifting from the Left

The experiences of the three economists differed. First, consider Hirshleifer. When he was about 16 years old, he

> did have the good luck of encountering something not anti-socialist but anti-communist. There's been really such a cover-up on the influence of Communism on the intellectuals. The question of the Soviet Union—was the Soviet Union paradise on earth?—that was the big dividing line. Everybody was a socialist but some people were for the Soviet Union, and, really, they were the only organized ones. So those of a skeptical turn of mind didn't question socialism but they questioned whether the Soviet Union was really as wonderful a place as was advertised. There were various influences upon me that I encountered that, after a while, at least made me immune to the attraction of Communism. I learned that it was all a lie, and I think this probably led to me questioning even the socialist idea. . . . By that time, I'd been debating politics for years in high school—that's what we did. (Henderson 1998c, 11:00)

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One of the big events that affected Hirshleifer's views was the Nazi-Soviet pact:

> I still remember, for example, the *shock* of the Nazi-Soviet pact. . . . I would have been 14, and, of course, at that time I was still somewhat open-minded, at least open to the idea that the Soviet Union was a wonderful place and all that, and then that they would sign this treaty with the Nazis was just a tremendous shock. By that time, I was already "sophisticated," that is to say, I was very, very aware of the political significance of what was going on. . . . And, of course, then the Communists said, "Yeah, but Stalin's only playing a trick on Hitler, you know, and when the time comes he will oppose Hitler." Which, of course, did happen, but only on Hitler's initiative, not on Stalin's. (Ibid.)

During World War II, Hirshleifer joined the Navy in a special program that allowed him to get an undergraduate degree from Harvard. At Harvard, he took courses from Joseph Schumpeter, Wassily Leontieff, Gottfried Haberler, and Alvin Hansen.

> Gottfried Haberler [was] perhaps the first classical liberal economist that I encountered in person. . . . I think that was the first time I realized that there were theoretical reasons to object to socialism. (Ibid.)

What were the specific sources of Hirshleifer's theoretical objections to socialism? Questioned about this, he responds:

> I would say the dominating thing was simply the reading lists in the courses. Hayek and Friedman would appear on the reading list . . . and as I read, I realized that the whole thing was a lie, well, at least a stupid mistake. (Henderson 1998c, 16:00)

Asked if 1942 wasn't too early for Milton Friedman's work to be on reading lists, he allows that he must have been projecting Friedman's later influence on his thinking back to the early 40s. But one book Hirshleifer believes influenced him early on was Schumpeter's *Capitalism, Socialism, and Democracy*.

"By the time I got to graduate school," says Hirshleifer, "I wasn't a socialist any more. But I didn't know what I was" (Henderson 1998b, 20:00). From then on, the process was gradual. After earning his Ph.D. from Harvard in 1949, Hirshleifer went to work at the RAND Corporation in Santa Monica. "Being at RAND and being around Reuben

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Kessel and Andy Marshall completed [my] transition to classical liberalism," Hirshleifer recalls (Henderson 1998c, 21:00).

So if one is looking for the turning point in Hirshleifer's transformation, it would have to be one or both of two things. The first was the Hitler-Stalin pact, which clearly upset him: in retrospect he refers to Communism and, to some extent, socialism, as a "lie." The second was his exposure to free-market views from such teachers as Schumpeter and Haberler and from the reading lists of some of his other professors. After that, his transition to classical liberalism was gradual through the early 1950s and was essentially complete by the time he had reached his late 20s.

For Rottenberg even more than for Hirshleifer, purely intellectual influences were important. After being a socialist before and during World War II, Rottenberg took a course in labor economics at Harvard from Sumner Slichter in the late 1940s, when Rottenberg was in his early 30s. During the course, Slichter challenged Rottenberg's view that a labor union's power depends solely on the percentage of workers in a particular industry who are unionized. This seemingly un-earth-shattering challenge actually demolished Rottenberg's worldview.

> Slichter said that it [the power of a labor union] depends on the price elasticity of the demand for labor; that is to say, a labor union of a particular class of workers is powerful if employers simply cannot do without those workers. But if, in fact, there are substitutes for those workers, then that labor union has less power. So the less adequate the substitutes for the workers, the more powerful is the union. . . . I thought, "he's right" and all these things I had been believing about [how] the power of a union depends upon the proportion of workers of that class who are organized is wrong. What really favorably affects the power of a union is that there are no good substitutes for the services of its members. And that was the revelation I came to in that class. . . . As a consequence, what's the fraction of workers who are organized, that the power of a union depends upon that, had come out of my socialist experience. That's what socialists believed. . . . What really is important is the other thing: are there good substitutes for the services of the workers or not? And when I came to that realization, then I resigned from the Socialist Party because all these things they were teaching me in the Socialist Party—well, that was exemplary of things I had been taught in the Socialist Party—and so I resigned. (Henderson 1998b, 13:00)

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Like Rottenberg, Buchanan was profoundly influenced by a teacher. In his autobiographical book, *Better Than Plowing,* Buchanan tells how he came to believe so strongly in free markets, and, tellingly, titles the chapter "Born-Again Economist." Buchanan (1992, 68) writes:

> I am not a "natural economist" as some of my colleagues are, and I did not "evolve" into an economist. Instead I sprang full-blown, upon intellectual conversion, after I "saw the light."

What led to this conversion was his first course in graduate economics from the legendary Frank Knight at the University of Chicago.

> I was not the only one. Out of a class of 40 or 30, I would say that 99 percent of us were socialists one way or the other and we were exposed to Frank Knight. After six weeks, half of us had been converted and half of them hadn't changed their mind, didn't change their mind. Why? What happened? It was not unique with me. I think, first of all, somehow or another Knight was able to convey the way an economy works, the integrating aspects of an economy. Now you say, "Well, economists ought to have known that, you know." Sure, but a lot of economists never learned it, they never get the light, so to speak. And the big picture sort of fit together. . . . I came into that class a libertarian socialist, [with] a feeling that the market was manipulated by the Wall Street barons or something like that—maybe to control the market you needed some democratic controls, you were a socialist in that sense—but you were never pro-state, at least certainly I was not—you were never pro-government, you were kind of libertarian, you were a strong believer in individual liberty. Yet if you didn't understand how the market works, you sort of necessarily [thought] politics might be better than Wall Street, you see. Then you're—at least I was—totally vulnerable. Once you learn the coordinating properties of the market in the larger sense, the economic organization, so to speak, Frank Knight's term, then it was there. (Henderson 1998a)

Two key ideas Buchanan learned from Knight were Adam Smith's concept of the invisible hand—the idea that when self-interest is pursued through free markets, the economy is coordinated without the need for any central government control—and the idea that both parties to an exchange gain from it, or they wouldn't make the exchange.

Buchanan, along with his colleague Gordon Tullock, essentially cofounded the school of thought known as public choice. Their central idea is that a great deal of political behavior can be explained by assum-

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ing that people acting in the political system, whether as voters, politicians, or bureaucrats, pursue their own self-interest, just as they do in the economy. This public-choice view has led the vast majority of its devotees toward strong skepticism about government.

What's striking, though, is how little Buchanan's views were formed by his experience of government during World War II, when government spending reached about 50 percent of GNP.

> Henderson: One of the things I hadn't known before reading your book is that you had been in the Navy, and at such a high level, not in the sense of rank but in the sense of responsibility and where you worked [he was on Admiral Nimitz's staff at Pearl Harbor]. How did that affect your view of the federal government, because, after all, that was a federal government activity?
>
> Buchanan: I don't think I made that translation.
>
> Henderson: One thing that surprised me was that when I read [the chapter of your book on your Navy experience], I was expecting to see more of a public-choice perspective taking form, but it didn't really.
>
> Buchanan: None at all, none at all. (Henderson 1998a, 7:00)

Contrast this with, for example, economist Thomas Sargent, who became much more skeptical of government because of his experiences working in the Pentagon during the Vietnam war:

> I went through ROTC, was commissioned, and then worked in the systems analysis office of the Pentagon. It changed me in some ways, made me more conservative. I came to understand more clearly the limitations of government actions. It was a learning experience. My conclusions came from seeing the whole decision-making process by which the U.S. got into the war: how we evaluated the situation, how we processed the data from the war, how we understood our options, what we saw as the resources and costs in Southeast Asia, and what we thought was the likely outcome. We didn't do a very good job. There was an incredible volume of inefficient and bad decisions, which one must take into account when devising institutions for making policy. (Klamer 1984, 62)

For Buchanan, by contrast, his belief in public choice came about, as he has documented elsewhere (Buchanan 1992) and confirmed in my interview with him, not from experience but from reading Knut Wicksell's untranslated doctoral dissertation. His skepticism about govern-

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ment was reinforced during a year that he spent studying the work of Italian public-finance economists:

> The Italians had "extreme cynicism and extreme skepticism" [about the state]. Even though they went through the Mussolini period, they never trusted the state. Even now, the difference in attitudes to the state between the Italians and the Americans is extreme. We still have this kind of romantic vision. It was very difficult to cut through that. In a sense, public choice is "politics without romance." It's hard to cut through that romance . . . because we want to believe that somehow government is doing good things for us. That's a natural proclivity. The Italians have never believed that. They think it's out to screw us, which is a much more realistic view. (Henderson 1998a, 36:00)

* * *

It is striking that ideas played a major role in all three of these conversions. Empirical observation mattered, especially to Hirshleifer, but what mattered much more to the other two, and even to Hirshleifer when he needed to fill the void left by his disillusionment with socialism, were the ideas that they were taught and that they learned in the readings assigned in their economics courses.

Simply put, what made these leftists into capitalists was learning the teachings of free-market economics.

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Jerry Z. Muller

CAPITALISM, SOCIALISM, AND IRONY: UNDERSTANDING SCHUMPETER IN CONTEXT

ABSTRACT: *The significance of the major claims of Joseph Schumpeter's best-known work,* Capitalism, Socialism and Democracy, *have often been misunderstood by readers unattuned to its ironic mode of presentation. The book reaffirms two themes that were central to Schumpeter's thought from its very beginning, namely the significance of creative and extraordinary individuals in social processes, and the resentment created by the innovations they introduce. The thesis that socialism would replace capitalism, but that it would bring about few of the advantages imagined by socialists and many disadvantages with which they had not reckoned, was an ironic proposition, which Schumpeter put forth in a manner designed to overcome intellectuals' dogmatic resistance to capitalism.*

Within recent years, three book-length biographical studies of Joseph Schumpeter have appeared.[1] A four-volume collection of secondary essays on Schumpeter's work has recently been published (Wood 1991) and a recent bibliographical volume lists over 1,900 secondary works on one or another aspect of his thought (Augello 1990). Several volumes of his previously uncollected essays have been published in the last decade, and more are on the way. Under these circumstances, to suggest that Schumpeter is "misunderstood" must seem

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counterintuitive, if not perverse. Yet when one examines these works one discovers the difficulties of appreciating and evaluating Schumpeter's *oeuvre*. Many of the secondary works on Schumpeter are skewed by the political and disciplinary commitments of his commentators. Two of the recent Schumpeter biographies treat him primarily as an economist; a third as a sociologist. Some secondary works on Schumpeter treat him as a herald of socialism, thereby distorting his intentions and message.[2]

It is as an analyst of the process of economic development in established capitalist societies that Schumpeter is best known, and it is among economists that he has had the largest audience. W. W. Rostow, himself a distinguished student of economic development, recently declared, "on balance, I regard Schumpeter as one of the most creative economists of the twentieth century and still underrated by mainstream economists" (Rostow 1990, 627n84). Yet a theory that emphasizes the intangibles of psychological types and cultural processes has proven unassimilable to a discipline that has been increasingly mathematized, and that takes as its dictum, "If you can't count it, it don't count."[3] Even worse, as Robert Heilbroner has noted, "the cutting edge of [Schumpeter's] insight was gained at the expense of the strict economic logic that gave such power to the visions of the classical [economists]" (Heilbroner 1986, 306.) It is Schumpeter's departure from "strict economic logic" in the explanation of economic and political phenomena that makes his work so stimulating, even as it renders him an outsider to the disciplines of economics and political science.[4]

Schumpeter's *Capitalism, Socialism and Democracy* was first published in 1942. At the time Schumpeter was a professor of economics at Harvard, where he had been a permanent member of the faculty for ten years. Schumpeter had been at work on the book since about 1935, but it includes many of the key ideas he had developed during the previous three decades. Writing in the midst of the deepest economic depression the United States had ever known, he argued that capitalism had been a great source of economic betterment for the mass of the population, and that despite the current downturn there were excellent reasons to believe that it was capable of continuing to alleviate material want. Although Schumpeter explicitly agrees with Marx's prediction that capitalism will be superseded by socialism, this is not because capitalism is economically inadequate, but because it creates social and cultural forces that lead to its demise. Thus, as

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Schumpeter informs us in the original preface, "I have tried to show that a socialist form of society will inevitably emerge from an equally inevitable decomposition of capitalist society"—a proposition that, he notes, "is rapidly becoming the general opinion, even among conservatives." But he quickly goes on to note his "paradoxical conclusion: capitalism is being killed by its achievements" (Schumpeter 1942, ix–x).

The book's significance is complicated by the fact that much of it is written in the ironic mode, so that its "message" is at odds with its explicit thesis.[5] Though this will be obvious to most careful readers, it is a fact that has been missed by many, including a fair number of commentators who have classified Schumpeter as a socialist.[6] Tom Bottomore's introduction to the edition currently in print gives the reader no indication of the ironic quality of the work being introduced.

Why would anyone, especially a social scientist, write a book in the ironic mode? I hope to cast some light on the intended messages of the book by examining some of the ongoing motifs in Schumpeter's work, and the experiences that led him toward a strategic use of irony.[7]

Elites: Economic, Intellectual, and Political

Schumpeter was born in Moravia in 1883 in what was then the Austro-Hungarian empire, the scion of several generations of entrepreneurs. After the death of his father, his mother moved to Vienna, married an aristocratic army officer, and sent her only son to the prestigious *Theresianum*, where he rubbed shoulders with the cream of the empire's aristocracy and upper bourgeoisie. At the universities of Vienna and in Berlin, he studied history, sociology, economics, and law. In 1905–1906 he participated in a now-famous seminar on Marx's economics led by Eugen von Böhm-Bawerk; other participants included Ludwig von Mises, Otto Bauer, and Rudolf Hilferding. In 1906 Schumpeter studied with the great German economic historian, Gustav Schmoller, in Berlin. Then he made his way to the London School of Economics, where he encountered the ethnologist Alfred Cort Haddon; an interest in the work of the British eugenicists Francis Galton and Karl Pearson appears to stem from the same period. After graduating with a law degree from the University of

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Vienna, Schumpeter moved to Cairo, where he became an associate of an Italian law firm, managed the money of an Egyptian princess, and made himself a fortune. In his spare time, he wrote a book on the nature of economic theory, which qualified him to teach in an Austrian university. In 1911, at the age of 28, he was appointed to a professorship in Czernowitz, in Bukovina, on the outer fringes of the Habsburg empire.

Two of the most pervasive themes of Schumpeter's *oeuvre* are Nietzschean. The first is the role of the superior few as a source of creativity; the second, the *ressentiment* of the many against the claims of the creative, and the stultifying effects of the resulting egalitarianism. These motifs run through Schumpeter's writings, from his earliest works through his posthumously published *History of Economic Analysis*.

A renewed emphasis on the role of elites was one of the most prominent features of European thought in the last decade of the nineteenth century and the first decades of the twentieth. The importance of elites had, of course, been a central theme of liberalism in the first half of the nineteenth century, leading to efforts to create legal conditions under which those of superior ability or creativity could rise and exert greater influence. But the spread of male suffrage in the last decades of the century and the new styles of mass politics to which it led; the growing electoral success of socialist parties; and the transformation of liberalism in a more egalitarian and collectivist direction produced, in response, a new focus on the need for elites and extraordinary individuals.

Nietzsche might be assigned the role of godfather to the new wave of elite theorists, not least because they borrowed so heavily from his analysis of the psychology of *ressentiment* in explaining contemporary socialism. In his *Genealogy of Morals* and elsewhere, Nietzsche had argued that modern liberal society was condemned to mediocrity because it had inherited the Christian ethic of meekness and humility. That ethic, he argued, was best understood as a doctrine that allowed the weak and inferior to devalue the strong, the creative, and the superior. Behind Nietzsche stood Carlyle, whose emphasis on the heroic personality Schumpeter (1954, 409–11) regarded as closer to his own economic sociology than utilitarian approaches to economics.

The theme of creative elites is adumbrated in explicitly Nietzschean terms in Schumpeter's first book, *Das Wesen und Hauptinhalte*

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der Nationalökonomie, published in 1908. After 600 pages devoted to explicating the static functioning of capitalism, Schumpeter emphasizes the need to study its dynamic elements, including entrepreneurial profit; and the need to treat in a scientific fashion what is often referred to as "effort"—*Wille zur Macht* or *Herrenwillen* (Schumpeter 1908, 615, 618). The role of creative elites in the process of economic evolution was the subject of his second major work, the *Theory of Economic Development*, published in 1911, in which Schumpeter laid out his theory of entrepreneurship. He argued that the laws of supply and demand, which had been the focus of economics since the time of Adam Smith, missed the fundamental dynamic of capitalism, as did the more recent attention paid to static equilibrium by Léon Walras. Capitalism needed to be understood in terms of its dynamic transformation, Schumpeter argued, and the source of that dynamism lay in the entrepreneur, a figure who had been rather neglected in nineteenth-century economic thought (though less so in the German tradition of *Nationalökonomie)*.[8]

Schumpeter distinguished the entrepreneur from the owner of capital, from the inventor, and from the manager. The function of the entrepreneur, in Schumpeter's theory, is to introduce economic innovation. Innovation can mean introducing new commodities or qualitatively better versions of existing ones; finding new markets, new methods of production and distribution, or new sources of production for existing commodities; or introducing new forms of economic organization.[9] The role of the entrepreneur was to break out of the routine of habitual economic life, and this required a rare mental creativity and energy (Schumpeter 1912, 86). It required *der Schöpferkraft und Herrschgewalt des Führers* (ibid., 304), a phrase that appears in the English translation of 1934 as "the creative power of a leader" (Schumpeter 1934, 147). Among the entrepreneurial innovations Schumpeter emphasized was the creation of large firms in industries that had never known such organization, leading to a more efficient utilization of the factors of production. This, he noted, was a difficult task requiring special talents, since considerable social and political resistance had to be overcome (Schumpeter 1912, 133).

For Schumpeter, the entrepreneur not only fulfilled an economic function, he represented a psychological type. This type could not be explained with reference to any hedonic calculus: it included "the dream to found a private kingdom," often a transgenerational dynasty; the will to prove oneself superior to others, for which fi-

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nancial gain is "mainly valued as an index of success and as a symptom of victory"; and "the joy of creating, of getting things done, or simply of exercising one's energy and ingenuity."[10] It is precisely the nonutilitarian elements of capitalist activity that Schumpeter sought to capture. As he later put it, in explaining the dynamics of capitalist development "utilitarianism can only be described as a complete failure since its rationalistic conception of individual behavior and of social institutions is obviously and radically wrong" (Schumpeter 1954, 409). Schumpeter also thought Adam Smith had been misled by egalitarian assumptions into underestimating the role of superior individuals.[11]

Even today, the radicalism of Schumpeter's analysis is startling The real—and only—long-term source of profit in the capitalist economy, he asserts, is the entrepreneur. Scientific discovery, often treated as an independent source of economic growth, is in fact a product of the process of economic growth, and it contributes to economic growth only through the activity of entrepreneurs.[12] It is the entrepreneur who is central to the organization of production, and his function is based on his personality (Schumpeter 1912, 529). As for the relative role of material factors and capital accumulation, Schumpeter asserted that even if all but the natural means of production vanished—as in the case of a lost war or a disaster—the economy would quickly be revived if its organization survived, together with the hierarchy that allowed those with the entrepreneurial traits of psychic energy and disposition to action to remain in control (ibid., 530–31).

Schumpeter (1912, 542–45) maintained that the process of innovation he had described could be applied to other areas of life as well. The distinction between leaders and led—between those who essentially continue in the given way of doing things, and those who see the new and change the inherited frameworks of activity—held for every area of life, not just the economy. Indeed, it could form the basis of an empirical philosophy of history (ibid., 548). The significance of differences in individual talent and energy would remain a *Leitmotif* of his subsequent work.[13] Time and again he returned to the theme of leadership, in the sense of "practical initiative," as essential to understanding not only economic development, but development in the arts, sciences, and politics.[14]

Indeed, in a lecture of 1910, Schumpeter emphasized the need for social scientists to be able to empathize with those above them on the

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social scale—a process, he noted, that was more difficult than empathizing with those below one's own station. Most social scientists, who tended to be of middle-class status, had few problems sympathizing and empathizing with the working class. But when it came to the study of economic elites, they were more prone to engage in moralistic condemnation than in empathetic comprehension (Schumpeter 1915, 21–22). Schumpeter clearly saw his work as an antidote to this propensity.

From the beginning, then, Schumpeter considered the role of a creative elite in social evolution to be a general problem, the implications of which he would explore in economics and then elsewhere.[15] In the prewar years he lectured on social class at Czernowitz, and then again as a visiting professor at Columbia University in 1913–1914. The upshot of this inquiry was published in 1927 as "Social Classes in an Ethnically Homogeneous Environment." Here Schumpeter insisted on the importance of "aptitude"—both aptitude that is inherited genetically, and that acquired from existing familial class position—in explaining social stratification (Schumpeter 1927, 273–77).

Schumpeter would emphasize once again the centrality of elites in the section on "Democracy" in *Capitalism, Socialism and Democracy*, where he argued that the rationalist and egalitarian prejudices of democratic political theory cloud the social-scientific explanation of how democracies actually function. Just as he argued that economic theory misconstrues reality when it treats the entrepreneur as reacting to consumer demand, rather than as *creating* wants previously unknown to consumers through advertising and the marketing of new products, so, he argued, political theory is fallacious when it portrays political decisions as welling up from rational and well-informed voters. The problem with this explanation, he thought, is not the absence of information available to voters: it was the lack of incentive for most voters to acquire the necessary facts, the unlikelihood that most of them would have the skills needed to evaluate the policy ramifications of the available information, the low personal cost of allowing voting to be guided by irrational sentiments rather than well-considered judgments, and the absence of readily interpretable feedback to determine which policies accomplished their ends and which did not. It is far more realistic, he argued, to conceive of democracy as a competition for votes among elites, who set the terms of debate and make the ultimate decisions.[16]

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The Revolt of the Masses

The second Nietzschean theme running through Schumpeter's work is that of *ressentiment*, the psychological antipathy of the inferior many toward the superior few, which leads the masses to seek devalue the achievements of the creative and successful.[17] This theme appears in Schumpeter's work at least as early as his *Theory of Economic Development* of 1911, in which he launches his claim that anti-entrepreneurial sentiment is inherent in capitalist society. The dynamism injected into capitalist society by the entrepreneur makes him a perennial object of abuse, Schumpeter argued. The rise of new entrepreneurs, and with them, new means of production and organization, necessarily means the relative decline of the economic position of those ensconced in the status quo, from farmers and artisans to the beneficiaries of earlier stages of capitalist innovation, who disdain the innovative entrepreneur as a *parvenu*. The process of downward relative social mobility, Schumpeter stressed, was an inevitable counterpart of the dynamic side of capitalism, which he would later call "creative destruction" (Schumpeter 1912, 534ff.). Very early, then, Schumpeter began to agree with Marxist theses, though for quite un-Marxist reasons. Like Marx, Schumpeter argued that capitalism creates its own opposition. But this opposition arises not because of material impoverishment, but because of the psychological resentment created by entrepreneurial dynamism.[18]

Similar processes explain, for Schumpeter, the appeal of socialism. Two decades ago, Carl Schorske (1980) confined his analysis of irrationalism in late nineteenth-century European politics to nationalism, Zionism, and anti-Semitism, all of which he grouped under the rubric of "politics in a new key." Schorske's thesis reflects his assumption that Marxism was a rationalistic legacy of the Enlightenment, and that the failure of socialism can be explained by the irrational appeal of opposing movements.[19] Yet the view of the major social theorists of the early twentieth century was quite different. To Vilfredo Pareto and Gustave Le Bon, for instance, the central mass irrationalist movement of the day was not so much radical nationalism as socialism. Himself a distinguished liberal economist, Pareto regarded socialism as economically irrational, so he sought to explain why it was nonetheless attractive to both the working-class masses and bourgeois intellectuals.

Pareto, whose work Schumpeter much admired, was perhaps the

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best-known turn-of-the-century elite theorist.[20] Pareto's essay of 1901 on "The Rise and Fall of Elites" conveys two themes to which Schumpeter would return time and again: the inexorability of elites, and the importance of nonrational and nonlogical drives in the explanation of social action. Like Schumpeter too, Pareto suggested that the victory of socialism was "most probable and almost inevitable." As in the case of Christianity, however, the doctrine would triumph, while the reality of elites would not change (Pareto 1991, 39–40). It was almost impossible to convince socialists of the fallacy of their doctrine, Pareto suggested, since they were enthusiasts of a substitute religion. In such circumstances, he contended, arguments are invented to justify actions which have been arrived at a priori (Pareto 1991, 50). The refutation of Marxist theory had not harmed socialist faith at all, since "it was not the book by Marx which has created the socialists; it is the socialists who have made Marx's book famous" (Pareto 1991, 100).

For Schumpeter, explaining the appeal of socialism was a life-long subject of interest.[21] Paraphrasing Hobbes, who (referring to the fact that his mother gave birth to him prematurely, out of shock at the approach of the Spanish Armada) famously said that he and fear were born twins, one might say that socialism and Schumpeter were born twins. He began his intellectual life at a time when the socialist parties of Austria and Germany were on the rise. As we will see, it was the threat of imminent socialization of the economy that led him to develop his ironic strategy of persuasion, and it was the fear of socialism that led him to pen his most lasting work, *Capitalism, Socialism and Democracy*. Very early on in his intellectual career he was in close contact with the most distinguished socialist intellectuals of the age, and he maintained such contacts throughout his life (one of his last fights at Harvard was to get tenure for Paul Sweezy). He was, therefore, well aware of the attraction of socialism to the best and the brightest. This explains, too, why he was an early and careful reader of Marx.

World War I and Schumpeter's Ironism

The years of the First World War and its immediate aftermath were personally engrossing for Schumpeter and a disaster for the institutions dearest to him.

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It was during this period that, for the first and last time in his life, Schumpeter was drawn directly into government and politics—in keeping with the tradition of Viennese professors of economics, who frequently served in high governmental posts.[22] From about 1916 he began to travel with increasing frequency from his university post in Graz to Vienna, and to send memoranda on economic and political affairs to the monarch and to highly placed members of the aristocracy. Schumpeter opposed a customs union with the German Reich, recommended a more forceful pursuit of peace, and favored a more assertive monarchy that would create a consensual basis for the empire through a more federative structure and an end to favoritism toward Germans and Hungarians.[23]

With the collapse of the Hohenzollern and Habsburg empires, and with communist revolutions in progress in Russia, Budapest, and Munich, Schumpeter served on the German government's coal socialization commission in late 1918 and early 1919. In March of 1919 he was asked by the new Austrian government of Karl Renner, which was composed of Socialists and Christian Socials, to serve as Minister of Finance. This he did for six tumultuous months, until he was forced out for reasons having to do with economic policy (he opposed the Socialist position on nationalization of industry), foreign policy (he opposed *Anschluss* with the German Reich at a time when it was favored by both major parties), and accusations that he worked behind the scenes to prevent the socialization of the Alpine-Montan Corporation, the largest iron producer in Austria and the linchpin of the government's socialization program.[24]

For Schumpeter, the collapse of the monarchy was a shock, as it was for the class of German-speaking *Bürger* and *Bildungsbürger* to which he belonged. They tended toward secularism and commitment to economic liberalism and the rule of law. Their cosmopolitanism took the form of attachment to a monarchy that served to integrate a polyglot empire. At odds with the anticapitalist inclinations of the aristocracy, of the lower-middle-class Christian Socials, and of the Social Democrats, as well as with the nationalist ambitions of the Slavic minorities, this most economically and culturally modern sector of Habsburg society paradoxically looked to the seemingly archaic imperial house to protect its position and its modernizing project.[25] For Schumpeter (and for others from this milieu), the collapse of the Habsburg empire meant the end of the world from which they drew their cultural breath. To most of them it seemed that the Empire,

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though "indefensible" in terms of the modern doctrines of nationalism and of democratic self-determination, was in fact the most "rational" political structure for the region in being best suited to the economic and cultural development of all the peoples within it. Indeed, the Empire was useful above all, they would tacitly add, to the non-German minorities most in need of economic and cultural development, which only the empire could bring, and which was woefully lacking in most of the successor states.[26]

The lasting impact of the collapse of the Empire on Schumpeter's work was a recourse to irony in two distinct senses. The first was a distanced perspective from which to view history. The observer (Schumpeter) could stand over and above the action, reflecting on the gap between the actors' understanding of their actions and reality. The beneficent intentions of the actors would lead to unintended negative consequences that the actors did not anticipate, but that the wiser and ironic social-scientific observer could demonstrate. Second, the observer, having demonstrated the gap between the intentions of the actors and the likely outcome of their actions, insists that his rational demonstration of the unanticipated negative consequences of the actions he described would not prevent the actors (his readers) from trying to carry through their plans, since those actors were motivated by nonrational motives.

Why adopt such a rhetorical strategy, which might appear to insult the reader? The intention is to induce self-recognition in the reader, and thus encourage him to open his mind to an otherwise unpalatable argument (Berger 1997, 41).

Schumpeter's Critique of Socialism

Schumpeter applied his ironic strategy not, however, to questions of nation and empire as much as to economic issues. The most distinguished economic minds of German and Austrian socialism, such as Otto Bauer and Rudolf Hilferding, had given little thought to the actual workings of a socialist economy. But the radicalization of the working class in the closing year of the war led them to turn toward practical suggestions for a post-capitalist economy. In the meantime, revolutionaries in Russia, Hungary, and Munich were attempting to implement socialism, with uniformly negative results.[27] Vienna, like many major German cities, was dominated by workers' and soldiers'

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councils. These were regarded with suspicion by the leaders of the Socialist parties, who feared they would lead to a Bolshevik-style takeover. Radical workers, believing that socialization would improve their economic situation, protested the inaction of the Socialists by rioting. In April and June of 1919, Communist attempts to seize buildings in Vienna were put down by police action. Throughout 1919 and 1920 workers in Vienna, often at the initiative of the councils, engaged in violent protests, including looting shops and wrecking cafés in the *Innenstadt*. In the words of one recent historian of the period, "It should surprise no one that the Viennese middle class and its political spokesmen viewed these violent outbursts as the end of civilization and the prelude to Armageddon" (Gruber 1991, 18–20; cf. Jelavich 1987, 164–65, and Gerlich 1980, 99).

As political attempts to actualize socialist ideals by either democratic or revolutionary means came to seem possible, liberal social scientists such as Max Weber turned to the intellectual refutation of socialism.[28] Some of Schumpeter's Viennese contemporaries, such as Ludwig von Mises and, later, Friedrich von Hayek, set out to prove by rational demonstration that socialism was economically unfeasible, which led to the famous "socialist calculation debate."[29] Beginning with his essay of 1918 on "The Crisis of the Tax State" and continuing throughout the 1920s and beyond, Schumpeter, too, remained a staunch, though flexible and undogmatic, advocate of market-oriented economic policies. As a contemporary analyst of the economic problems of the Weimar republic after his move to the University of Bonn in 1925, he advised against excessive government intervention. He emphasized the problem of low capital formation, which he attributed to excessive wage demands by unions, as the major barrier to economic growth.[30] The difference between Schumpeter on one hand and Mises and Hayek on the other lay less in their fundamental economic policy recommendations than in the rhetorical manner in which they sought to stave off socialism.

In postwar Austria and Germany (and then, later, in New-Deal America), Schumpeter seemed to feel that a frontal onslaught against socialism would make little headway among intellectuals. Instead he offered a series of arguments about why socialism was not desirable under present circumstances. The time for socialism, he consistently maintained, was in the future: the time for capitalism was now. And, he added, socialism would bring about few of the goals and expectations of the socialists themselves. Its viability could be purchased

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largely at the expense of its desirability. The notion that what seems rational to "enlightened" opinion might be profoundly mistaken was central to the Schumpeter's subsequent work. As he put it in *Capitalism, Socialism and Democracy*, "The rationalist attitude may go to work with information and technique so inadequate that actions—and especially a general surgical propensity—induced by it may, to an observer of a later period, appear to be, even from a purely intellectual standpoint, inferior to the actions and anti-surgical propensities associated with attitudes that at the time most people felt inclined to attribute to a low I.Q." (Schumpeter 1942, 122).[31]

Many of the key themes of *Capitalism, Socialism and Democracy* were adumbrated in Schumpeter's first highly ironic work: a long essay of 1920, "*Sozialistische Möglichkeiten von heute*."[32] Given the public's minimal understanding of how capitalism actually works, he began, there was a need to restate certain obvious truths. The socialization of the means of production and conscious economic planning would not bring an end to "the anarchy of free competition," since the competitive market economy is in no sense anarchic. On the contrary, he argued, "the combined effect of individual egoisms of economic subjects results in a whole, which from the point of view of the outside observer must give the impression of a conscious plan as much as does the economy of a socialist society guided by a central organ." Nor did the distinction between a socialist and a capitalist organization of the economy lay in the fact that one serves the public while the other serves only individual interests, he asserted, for the profit motive that drives the production process in a competitive economy serves the interests of all as much as a planned economy would (Schumpeter 1921, 310–11).

What most of the mass supporters of socialist parties had in mind when they spoke of socialism was the confiscation and redistribution of consumer goods. But the result of such measures would be to bring economic life to a halt and to destroy "cultured private life" (Schumpeter 1921, 336). "Socialization with a pleasant life and plentiful income—that childish ideal of enrichment through appropriation of existing wealth—is politically attractive, but it is nonsense," he wrote (ibid., 308). Responsible socialists, Schumpeter charged, exhibited a failure of courage in refusing to acknowledge "the fact that socialization would have as its effect the unavoidable regression of production, and a worsening of the already dire economic circumstances of all strata," as well as the fact that "for socialization to be successful

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would require the imposition of an unprecedentedly strict level of discipline upon the working masses."

Nevertheless, Schumpeter continued, a number of social processes that were a product of capitalist economic development would, in the long run, lead in the direction of socialism. The competitive capitalist market destroys traditional, uneconomical forms of production, thus rationalizing the economy. This process of rationalization performs the "necessary preliminary work for socialism." When the process has proceeded far enough, he suggested, it would be possible to replace the "automatic" rationalization brought about by capitalism with a more conscious policy. Over the long run, Schumpeter added, the classic functions of the entrepreneur would become less necessary and might be systematized into teachable methods. Then one would see a decline of the social significance of the entrepreneur and of the capitalist: as their functions became less essential they would slowly go the way of the aristocracy after the decline of knighthood. In addition, as familial ownership and operation of enterprises gives way to shareholding, in which actual operation is in the hands of paid managers, there is a loosening of attachment to private property. Thus, according to Schumpeter (1921, 312–19), capitalism, in rationalizing the economy, also digs its own grave.

Socialists ought to welcome ongoing capitalist development for other reasons as well, Schumpeter suggested. The goal of socialism was to end the need for economic activity as the prime task of life. But that would only become possible after the buildup of tremendous capital, especially since the problem of renewing capital through saving was a central conundrum for socialists. It was best, then, to begin socialism from a high level of economic production, which capitalism was more likely to bring. Because of its difficulty in creating savings and investment, socialism required demographic stagnancy. But even here capitalism was preparing the way, Schumpeter (1921, 323) contended, suppressing irrational impulses and thereby bringing down the birth rate.

Socialism will slow down economic development, Schumpeter explained, but this is consonant with its purpose of freeing human energies from economic concerns. That remained a future prospect. For the present, though, socialization of the means of production would be disastrous, alienating the most productive citizens and thus leading to a decline in the standard of living and to social conflict. Therefore the current policy of any rational socialist must be to encourage the development of capitalism (Schumpeter 1921, 343–46). After having

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presented his arguments in favor of continued capitalist development, Schumpeter (1921, 348–49) added that "of course these arguments have no impact on the convinced socialist," who has "a mystical, religious, or substitute-religious non-rational faith in socialism, which cannot be overcome by any argument, proof, or fact." Against socialists, one might say, only irony might work.

Schumpeter returned to these themes occasionally in his writings of the later 1920s. In "*Unternehmerfunktion und Arbeiterinteresse*," published in 1927, he reiterated his belief in the economic inefficiency of socialism relative to capitalism. In his 1928 article, "The Instability of Capitalism," published in the *Economic Journal*, he asserted that "capitalism, whilst economically stable, and even gaining in stability, creates, by rationalizing the human mind, a mentality and style of life incompatible with its own fundamental conditions, motives and social institutions, and will be changed, although not by economic necessity and probably even at some sacrifice of economic welfare, into an order of things which it will be merely a matter of taste and terminology to call Socialism or not" ([1928b] 1989, 386).

The Depression and Intellectuals' Interpretation of It

Many of the key points in the famous section of *Capitalism, Socialism and Democracy* entitled "Can Capitalism Survive?" appear in nonironic form in Schumpeter's 1938 book, *Business Cycles*. In this volume, Schumpeter sought to show that cyclical booms and busts were an inevitable part of the history and process of capitalist development, though the swings of the business cycle could be moderated by corporate and governmental understanding of the process. Toward the end of this mammoth work, Schumpeter offered his own analysis of the current depression and the chances for escaping from it.

At a time when many Marxists believed that the drastic and protracted downturn of the economy vindicated Marx's prediction of the ultimate crisis of capitalism, Schumpeter offered a far less apocalyptic diagnosis. Schumpeter contended that in the United States, the Great Depression originated in a confluence of long- and short-term cyclical factors, but that recovery had been slowed down and weakened by government policies. Through legislation such as the National Industrial Recovery Act of 1933, government policy had sought to stabilize the economic climate for existing businesses, rather

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than allowing economically obsolete firms to decline (Schumpeter 1939, 992–93). Moreover, government attempts to raise wages in the midst of the Depression had an adverse effect on business expansion and on employment levels (ibid., 994–95). What recovery did occur was due more to the "natural" effects of the business cycle than to government policy, the net effect of which was to get in the way (ibid., 995–96, 1026). (At the peak of the expansion of the U.S. economy that took place between 1933 and 1937, 14 percent of the labor force remained unemployed.)[33] It was government policy, Schumpeter believed, that had turned a "mere depression" into a "catastrophe."[34]

The Keynesian analysis of the Depression held that contemporary capitalism suffered from a shrinking of opportunities for investment. Schumpeter concurred, but not for the reasons offered by Keynesians. The problem, in his analysis, was that hostility to economic elites had led to a situation in which those who ought to have made the most significant innovative investments were discouraged from doing so. Steep income taxes and estate taxes on the highest-earning taxpayers, a special surtax on undistributed corporate profits, and a general perception that those implementing policy in the New Deal were antipathetic to capitalism all struck hard at the largest firms and the wealthiest individuals, reducing investment and innovation (Schumpeter 1939, 1039–41). "Since economic 'progress' in this country is largely the result of work done within a number of concerns at no time much greater than 300 or 400, any serious threat to the functioning of these will spread paralysis in the economic organism," Schumpeter wrote—a problem exacerbated by the decline of available capital, thanks to the high taxes on the 30,000–40,000 taxpayers with the highest incomes (ibid., 1044, 1039).

Schumpeter's defense of large corporations was part of his life-long support of the creatively superior. He thought that the attack on "monopoly" during the New Deal was motivated by egalitarian resentment of the successful.[35] Critics of monopoly in the name of free competition failed to understand that it was in the very nature of dynamic capitalism to produce the high, "monopoly" profits that accrued to those who successfully introduced innovations. Since their initial superiority had to be defended against further innovations, however, large firms that did not continue to innovate would decline. Those businesses that were often attacked as monopolies, Schumpeter wrote, "increase the sphere of influence of the better, and decrease the sphere of influence of the inferior, brains."[36]

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In short, Schumpeter believed that in America, too, anti-elitist *ressentiment* was killing the capitalist goose, creating "a situation in which neither capitalism nor its possible alternatives are workable." This was a result of the process by which "capitalism produces by its mere working a social atmosphere—a moral code, if the reader prefer—that is hostile to it, and this atmosphere, in turn, produces policies which do not allow it to function" (Schumpeter 1939, 1038, and ch. XIV, secs. B and C). This hostility was due not least to the influence of those who shaped public opinion—the intellectuals. In the early 1930s, the shock of economic collapse, and the dominant interpretation of the Depression by intellectuals, had led to a "radicalization of the public mind" in the United States, which in turn had resulted in the policies that had left capitalism in shackles. Feeling itself under attack, the "industrial bourgeoisie" responded by slowing down investment and innovation, creating a far weaker cyclical recovery than would otherwise have occurred (ibid., 1046–50).

In *Capitalism, Socialism and Democracy,* Schumpeter reiterated some of the ideas that had already been presented in declarative and analytic form in *Business Cycles*.[37] But now he put them in a highly ironic framework, since he had reason to believe that a frontal attack on socialism would meet with deaf ears on the part of younger intellectuals. At Harvard, Schumpeter faced an audience of graduate students that, as one of them recalls, was "super-saturated with Keynes, Marx, and Veblen." Although they were reflexively hostile to his message, he nevertheless "slyly 'got across' one point after another" (Wright 1950, 36). In *Capitalism, Socialism and Democracy*, he used the same technique. Irony served as a battering ram with which to open minds. That the days of capitalism were numbered, and that the capitalist era must now give way to socialism—these were assumptions widely shared by intellectuals on both sides of the Atlantic.[38] Schumpeter's ostensible concurrence served as bait, leading leftist intellectuals who would never nibble on (let alone take seriously) the work of a Hayek, to bite into *Capitalism, Socialism and Democracy*. Once Schumpeter had them hooked, he could get them to reconsider their assumptions.

Attacking Capitalism to Defend It

It is against this background that Schumpeter's best-known book must be read. In the ironic mode the stated may be the opposite of

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the intended. To understand an ironic work by accepting its stated conclusions at face value, in other words, is to invert its message. The explicit thesis of *Capitalism, Socialism and Democracy* is that, as Marx predicted, capitalism will and should be superseded by socialism. Along the way Schumpeter provided one of the most stimulating works of twentieth-century social thought, crammed with theses, analyses, and insights that led to the opposite conclusion.

Schumpeter began by writing that Marxism, which condemns religion as the opium of the masses, is itself best understood as a religion, since it provides a plan of salvation and a vision of earthly paradise. Marx's success lay in "formulating with unsurpassed force that feeling of being thwarted and ill treated which is the auto-therapeutic attitude of the unsuccessful many" (Schumpeter 1942, 6). Marx sneered at the "bourgeois nursery tale that some people rather than others became, and are still becoming every day, capitalists by superior intelligence and energy in working and saving." He was well advised to do so, Schumpeter wrote, "for to call for a guffaw is no doubt an excellent method of disposing of an uncomfortable truth, as every politician knows to his profit." In fact, Schumpeter suggested (alluding to his earlier work), "supernormal intelligence and energy account for industrial success and in particular for the *founding* of industrial positions in nine cases out of ten" (ibid., 16).

The further attraction of Marxism lay in its claim to explain everything according to a few principles. Marxists often explained imperialism by reference to the influence of big business or high finance on foreign policy. In fact, Schumpeter maintained,

> the attitudes of capitalist groups toward the policy of their nations are predominantly adaptive rather than causative, today more than ever. Also, they hinge to an astonishing degree on short-run considerations equally remote from any deeply laid plans and from any definite 'objective' class interests. At this point Marxism degenerates into the formulation of popular superstitions.

The Marxist's interpretation of imperialism was on the same level as those who explain modern history "on the hypothesis that there is somewhere a committee of supremely wise and malevolent Jews who behind the scenes control international or perhaps all politics" (1942, 55).

Despite Marx's conceptual shortcomings—which were dissected

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amidst frequent praise of Marx for asking the right questions—Schumpeter agreed with Marx that capitalist evolution would destroy capitalist society. But this was not, as Marx had contended, because capitalism led to the immiseration of the working masses. On the contrary, Schumpeter argued, the record of capitalism was one of unprecedented economic growth that had profited the working classes the most. "The capitalist achievement," he wrote, "does not typically consist in providing more silk stockings for queens but in bringing them within the reach of factory girls in return for steadily decreasing amounts of effort" (1942, 67). Moreover, left to its own devices, capitalism would continue to bring about economic growth and a rising standard of living. In short order he disposed of then-popular arguments that capitalist growth was permanently stalled due to vanishing investment opportunities, depleted natural resources, or innovation squelched by monopolies and oligopolies.

But capitalism would *not* be left to its own devices, Schumpeter asserted. It would be hobbled, and in the long run replaced—despite its economic success, and despite the fact, Schumpeter argued, that it was responsible for the growth of pacifism, the emancipation of women, and most of the other good things valued by right-thinking people. Capitalism would meet its doom because of the unintended effects of capitalist development, which sapped the social and cultural sources of its support. The commitment to private property once prevalent in a society of small enterprises was in decline because of the rise of the modern corporation, which concentrated the size and reduced the number of enterprises, replacing owner-managers with managerial employees who felt no strong attachment to property as such.[39] The cultural effects of capitalism also work against its preservation. The rationalistic mindset engendered by capitalism, the belief that each individual ought to submit institutions to a cost-benefit analysis, "rubs off all the glamour of super-empirical sanction from every species of classwise rights" and turns against the political and economic institutions of capitalist society.[40] Although, as Schumpeter (1942, 157–62) indicated, this "rationalism" often turns out to be wrongheaded, the harm it does to the authority of institutions is real enough, destroying some of the precapitalist institutions (such as the bourgeois family) on which capitalism has rested.

Furthermore, Schumpeter suggested, the merits of capitalism were too difficult for most people to grasp—an argument that creates in the reader a psychological incentive to understand them. In any case,

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the benefits of capitalism were general and long term, giving it little appeal to the unemployed who are inevitably thrown forth by the process of "creative destruction" that renders obsolete the existing means of production—and those employed in them.

The gravediggers created by capitalism also include the intellectuals, who exercise inevitable influence through their roles in education, in the formation of public opinion, and in the state bureaucracy. Schumpeter traced the hostility of intellectuals toward capitalism to their sense that the system does not reward them adequately, a feeling encouraged by its cyclical overproduction of the well educated. The resulting hostility toward capitalism made most intellectuals virtually impervious to rational argument.

> Capitalism stands its trial before judges who have the sentence of death in their pockets. They are going to pass it, whatever the defense they may hear; the only success victorious defense can possibly produce is a change in the indictment. Utilitarian reason is in any case weak as a prime mover of group action. In no case is it a match for the extra-rational determinants of conduct. (1942, 144)

In any case, he added, "socialist bread may well taste sweeter" to anti-capitalist ideologues "than capitalist bread simply because it is socialist bread, and it would do so even if they found mice in it"—just the sort of observation that warns the reader to attend to the mice.

Schumpeter concluded his examination of capitalism with an exquisitely ironic paragraph:

> I am not going to sum up as the reader presumably expects me to. That is to say, I am not going to invite him, before he decides to put his trust in an untried alternative advocated by untried men, to look once more at the impressive economic and still more impressive cultural achievement of the capitalist order and at the immense promise held out by both. I am not going to argue that that achievement and that promise are in themselves sufficient to support an argument for allowing the capitalist process to work on and, as it might easily be put, to lift poverty from the shoulders of mankind. (1942, 144)

Then Schumpeter turned to socialism. He began by arguing that a socialist economy is indeed economically plausible (1942, 172). This contention—which was bound to raise the hackles of more orthodox (or less ironic) defenders of capitalism, such as Hayek—should be read as a rhetorical strategy intended to keep the socialistically in-

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clined reader interested. Schumpeter also contended that socialism, depending on how it was defined, is compatible with a range of political forms, including democracy. But socialism is economically superior only to the fettered capitalism created by anticapitalist resentment, which diverts rivers of intellectual talent into unproductive activities, such as tax law, through which those with capital try to fend off the depredations of the state (ibid., 201, 198). And socialism would achieve economic growth only to the extent that it coopted those of superior intellectual ability and rewarded them with differential prestige. Thus, the economic success of socialism would be purchased at the cost of its egalitarian aspirations. Moreover, socialism was likely to bring about the increasing use of political force against workers, as the restraints on government were loosened with the elimination of private ownership of the means of production.

> There is little reason to believe that this socialism will mean the advent of the civilization of which orthodox socialists dream. It is much more likely to present fascist features. That would be a strange answer to Marx's prayer. But history sometimes indulges in jokes of questionable taste. (Ibid., 375)

The Reception of Capitalism, Socialism and Democracy

Herbert Zassenhaus (1981, 170), who studied economics at Harvard in Schumpeter's day, has noted that when *Capitalism, Socialism and Democracy* first appeared, "it resisted the attempt to identify it with any familiar orthodoxy. It seemed to be on both sides of too many issues; it refused, irritatingly, neat rubrication." D. M. Wright (1950, 195–96), another of Schumpeter's students and later his colleague at Harvard, wrote:

> I am often asked in America: "Did Schumpeter really take his pessimistic conclusions regarding the future seriously or is *CSD* a clever propaganda device?" No definite answer can be given. I doubt if he knew himself. . . . Schumpeter, I suggest, in a sense dared not publish a frontal defense of capitalism—perhaps he merely thought it futile. . . . To some extent *CSD* is an example of what I have called the Mark Antony technique. By coming first to "bury Caesar not to praise him" (capitalism is doomed) he was able to get people to read him who would otherwise not have sat still for a moment under his teaching.

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> "Brutus" moreover is "an honorable man" (socialism is workable). Having conceded that much he was then able to insinuate one of the most able defenses of capitalism ever published. How much he hoped to accomplish I cannot say.

In the preface to the second edition of the book (one deleted from the edition currently in print), Schumpeter spelled out his true motives less coyly and more explicitly. Rejecting the charge by proponents of capitalism that his book was "defeatist," he declares: "I deny entirely that this term is applicable to a piece of analysis. . . . The report that a certain ship is sinking, is not defeatist. Only the spirit in which the report is received can be defeatist. The crew can sit down and drink. But it can also rush to the pumps."[41] His book, he explains, was intended "to serve the reader" by providing an analysis that would "make him think" (Schumpeter 1947, xi). And so it did—and continues to do. The book's effectiveness in stimulating readers to a reassessment of their preconceptions is due not only to Schumpeter's learning or to his thoughtful ambivalence. It is attributable in no small part to the author's deliberate rhetorical strategy.

NOTES

1. Allen 1991; Swedberg 1991; Stolper 1994. März 1991 is a useful collection of essays on Schumpeter's thought and career.
2. These include the characterization of one of Schumpeter's major essays on socialism, "*Sozialistische Möglichkeiten von heute*" (1921), in März 1991, 109–111. Swedberg 1991, 46 quite rightly writes that Schumpeter "always detested socialism" and that his behavior as minister of finance only makes sense on this assumption. But Swedberg's subsequent discussion of *Capitalism, Socialism and Democracy* leaves out the ironic nature of Schumpeter's argument.
3. This skepticism was already foreshadowed in the initial reception of Schumpeter's *Business Cycles* in the review by Simon Kuznets (1940).
4. Jürgen Osterhammel (1987, 45) has made a similar point about the violence done to Schumpeter's thought when it is fitted into the rationalist assumptions of contemporary economics and of some forms of political science.
5. On the whole, those reviewers who shared Schumpeter's background caught the book's ironic drift. Fritz Machlup, reviewing the book in *The American Economic Review*, termed its style "humorous-ironic rococo." In his extensive summary, he hit upon virtually every major point of the book, and noted "the firm impression that Schumpeter dislikes socialism, nay, despises it. I

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read this between the lines only" (Machlup 1943, 302.) Similarly see Haberler 1950.

6. Including Edgar Salin, who wrote the preface to the 1946 German translation of the book.
7. Some have suggested that Schumpeter couldn't help himself: irony was forced upon him, so to speak. They point to his origins in Viennese high society and assume that his book simply reflected this cultural atmosphere. But most of Schumpeter's books were *not* ironic; they were rather straightforward in their mode of exposition, from his first major work on economic theory through his *Business Cycles* (1939). Other commentators treat Schumpeter's irony in *Capitalism, Socialism and Democracy* as a byproduct of his attempt to write for a larger, nonspecialized audience. But Schumpeter had lectured to and written for popular audiences since the beginning of his career, from his sparkling published lecture on "How to Study Social Science" of 1910 through a volume's worth of journalistic commentary on contemporary economic issues during the Weimar Republic—and few of these works were ironic. (They have been collected in Schumpeter 1985.) Other scholars have conflated the ironic tone of *Capitalism, Socialism and Democracy* with melancholy, which they attribute to Schumpeter's personal circumstances or his political isolation during the years when it was written. (See for example the recent biographical studies by Richard Swedberg and Robert Loring Allen). But while Schumpeter had had personal reasons for melancholia since the death in childbirth of his new bride and newborn son in 1926, during the intervening years he wrote many an unmelancholy and unironic work. In fact, Schumpeter began to employ ironic strategies of argument well before the death of his young wife.
8. On the neglect of the entrepreneur in economic theory, see Redlich 1955; and for more recent literature on the subject, Kirzner 1985, ch. 1. On the attention devoted to entrepreneurs and their functions among German-language economic theorists in the nineteenth century, see Streissler 1994, esp. 15–22 and 34–35. For a useful overview see Blaug 1997.
9. See Schumpeter 1934.
10. Schumpeter 1934, 92–93. Schumpeter's emphasis on the degree to which rationalist economic models cannot account for the behavior of the entrepreneur is discussed in Rosenberg 1994.
11. For the negative effects on economic analysis of ignoring elites, see Schumpeter's comments on Adam Smith in Schumpeter 1954, 186:

> A judiciously diluted Rousseauism is also evident in the equalitarian tendency of his economic sociology. Human beings seemed to him to be much alike by nature, all reacting in the same simple ways to very simple stimuli, differences being due mainly to different training and different environments. This is very important considering A. Smith's influence upon nineteenth-century economics. His work was the channel through which eighteenth-century ideas about human nature reached economists.

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12. Schumpeter 1912, 479–80. "*Ohne Leute, die zur Führerrole taugen, wären solchen Erfindungen tot.*"
13. In a little-known article on Schumpeter, M. Gottlieb acutely concluded that "Schumpeter provided a valuable working out in economic theory of the neglected elitist side of the case: the need for inequality, the contribution of direction by elites, the role of leadership, the need for sponsoring the conditions in which creative leadership can function, the need for industrial discipline and the role of coercion and fraud in society. Just as these elitist insights have their place, so Schumpeter's application of them to crucial economic processes developed a point of view which the dominant trend of radical-democratic ideology tended to submerge: the constructive contribution of big business, the dynamic contribution of many monopolist firms, the need for a certain amount of instability in a dynamic and progressive society, the real danger of fiscal radicalism in its insidious long-run warping of incentives and of resource patterns." Gottlieb 1959, 298.
14. Schumpeter 1928, 482. "*Auf allen gebieten des sozialen Lebens beobachten wir die Scheidung zwischen Führen und Geführten, die letzlich . . . auf Unterschieden der individuellen Befähigungen beruht, wobei das Gewicht erst in zweiter Linie auf intellektuellen Eigenschaften (Weite des Gesichtskreises, "Aufgewecktheit" usw.), in erster Linie jedoch auf Willenseigenschaften liegt. . . . Das Wesen der Führerschaft ist Initiative . . . im Sinn von praktischer Initiative.*"
15. Moreover, as his essay on social classes makes clear, Schumpeter appears to have paid attention to British developments in ethnology, eugenics, and the study of the family, all of which he thought useful but in need of critical assimilation by those "who know the relevance of what these disciplines have to offer." Schumpeter 1927; translation, 231–32.
16. Schumpeter 1942, Part IV; the quintessence of Schumpeter's argument is excerpted in Muller 1997, 277–84.
17. A frequent theme in Nietzsche's work, the locus classicus being *On the Genealogy of Morality.*
18. Schumpeters later work includes many suggestive passages that applied this analysis to the history of capitalism, going back at least to the sixteenth century. See for example Schumpeter 1946.
19. According to Schorske, "The Social Democrats . . . offered few conundrums to the liberal mind. . . . To the liberal mind, the Social Democrat was unreasonable, but not irrational." Schorske 1980, 118–19.
20. See Schumpeter's essay on Pareto in Schumpeter 1951.
21. By contrast, he seems to have found fascism fundamentally uninteresting, or at least not in need of his attention, perhaps because he thought it a passing phenomenon.
22. Johnston 1972, 48, 70, and ch. 4.
23. See the letters of Schumpeter to Graf Otto Harrach, a member of the Austrian House of Lords, written from 1916 to 1918, in Schumpeter 1992, 359–76.

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24. Seidl 1994, 69. Haberler 1950, 93 quite rightly notes that as Minister of Finance, Schumpeter worked against socialization and other radical economic measures.
25. See Jelavich 1987, 144–45; Silverman 1984, Introduction and ch. 1; and Hacohen 1993, 77–90. For an evocation of this milieu see the autobiographical reflections of Friedrich Hayek in Hayek 1994, 37ff.
26. For a recent reaffirmation of this analysis, see Mason 1997, ch. 4.
27. In the minds of leading German-speaking Social Democrats, such as Kautsky and Bauer, the Bolsheviks' attempt to bring about socialism in a backward economy was foolhardy, and their political methods barbaric. I do not know of an extended study of the German and Austrian socialist leadership's response to the Bolshevik Revolution, but their utter revulsion set the stage for the conflicts of the interwar left. For a brief description of Kautsky's response see Nolte 1987, 110.
28. See for example Weber 1918 and Weber 1978.
29. Many of the major documents are collected in Hayek 1935. For a discussion of the debate, see Steele 1992.
30. See the articles collected in Schumpeter 1985, and 36–43 of the introduction. More recent historians of the Weimar economy, such as Knut Borchardt and Harold James, have reached similar conclusions.
31. As Schumpeter notes, this insight goes back at least as far as the conservative critique of the Enlightenment.
32. Schumpeter 1921. Schumpeter's recurrent argument that while the time for socialism was in the future, the time for capitalism was now, first appears even earlier, in his "Crisis of the Tax State" of 1918 (in Schumpeter 1991).
33. For a recent analyis that essentially concurs with this element of Schumpeter's analysis, see Selgin 1999.
34. On Schumpeter's analysis of the Depression see also Rosenof 1997, 95–104.
35. Schumpeter 1939, 1044. He reiterated in the preface to the Second Edition of *CSD* (1947, x) that he believed that "*most* of the current talk about monopoly . . . is nothing but radical ideology and has no foundation in fact."
36. Schumpeter 1942, 101. As Neil McInnes has noted, Schumpeter destroyed the logical foundations of antitrust doctrine, but it refused to fall over. McInnes 1995, 94; this is a very intelligent recent review of the reception of *CSD* in the decades since its publication.
37. Most of the major themes of the book are mentioned by Schumpeter (1987, 196–219, esp. 207) in his review of Sombart, as key themes in the era of high capitalism that deserve comprehensive discussion, but are not systematically explored by Sombart.
38. As Schumpeter noted in the preface to Schumpeter 1942, ix–x.
39. An argument Schumpeter had put forth in Schumpeter 1928.
40. By "rationalism," Schumpeter means much the same as what Michael Oakeshott was to call "rationalism in politics" and F. A. Hayek "constructivism."
41. Preface to Schumpeter 1947, xi–xii. Similarly, Schumpeter ended his lectures

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at the Lowell Institute in Boston, delivered in March 1941, with a gloomy set of prognoses, only to add that

> the economic society either of 1914 or later was not in itself played out. The theory is this. The capitalist process produces in various ways which we have seen a social atmosphere hostile to itself, but that doesn't mean that the economic process itself is necessarily obsolete and unable to carry the strata it used to. Hence, fighting for capitalist civilization is not a hopeless task. The objective data for the temporary success of such a fight are still present; the strata themselves are still present. This being so, much then depends, as it always does in such situations, on good management by well-informed and cold rationality. (Schumpeter 1991, 398–99)

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Jane Humphries

CLIOMETRICS, CHILD LABOR, AND THE INDUSTRIAL REVOLUTION

ABSTRACT: *Ten years ago, Clark Nardinelli shocked conventional historians by reinterpreting child labor as a sensible response to the Industrial Revolution. Nardinelli's exculpation of child labor follows from the way in which he deploys neoclassical economic theory. How relevant is his neoclassical model to the early industrial economy, and how realistic is methodological individualism to the decisions that sent young children into the appalling work places of early industrial Britain? Rather than seeing neoclassical economics as a substitute for historical judgment, as Nardinelli suggests, I propose that we use it critically to probe the meaning and implications of child labor in its historical context.*

Historians with otherwise diverse opinions have been united in citing child labor as one of the worst aspects of the first industrial revolution. In *Child Labor and the Industrial Revolution* (Bloomington: Indiana University Press, 1990), Clark Nardinelli set himself what was therefore a mammoth task: to rehabilitate the widespread employment of children in the mills and manufactories of early industrial Britain.

Nardinelli is a cliometrician: an economic historian who applies orthodox neoclassical theory to the past. One of the most celebrated results of neoclassical economics is that competitive equilibria are Pareto optimal, meaning that under certain circumstances (to which we will

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return), individuals, acting rationally and in their own self-interest, will exploit all mutually advantageous opportunities for exchange. Whatever outcomes occur must be the best available; otherwise people would make new exchanges to produce a better result.

Two complications mar the otherwise awesome simplicity of this result. First, the optimality of the competitive allocation is relative to the initial endowments of the agents involved. If we begin with some people possessing very little in terms of scarce resources, the resulting allocation may be the best that they can do, but nonetheless miserable. Second, competitive outcomes are unlikely to be unique. In particular, a labor market where children are potential workers will be prone to have more than one equilibrium, each Pareto optimal. But if one leaves these points aside, neoclassical economics allows the modern economic historian, as Nardinelli bills himself, to cut through the sentimentalist twaddle of the conventional view of child labor, and to see it for what it really was—a rational response to the conditions of the time. "Families did not exploit children; they sent them into the labor market in order to increase family income and thereby improve the well-being of the children" (155).

Nardinelli sees not only the existence of child labor, but changes in its extent and importance, as rational responses to economic conditions. This means rejecting alternative explanations of change, such as shifts in attitudes or the introduction of protective labor legislation.

How well has *Child Labor* stood the test of time? Although recent empirical research has contributed to a critical perspective on Nardinelli's work, the strength of his central argument remains dependent on the persuasiveness of his application of neoclassical economic theory. Consequently it is the theoretical framework that is the central focus of this review.

The Cliometrics of Child Labor

In some ways Nardinelli is an identikit cliometrician. He is "an economist applying economic theory (usually simple) to historical facts (not always quantitative) in the interests of history (not economics)" (McCloskey 1978, 15). His study has the same "shock value" as other classic cliometrica, reinterpreting a morally abhorrent situation as "efficient," just as the first cliometricians did with slavery (e.g., Conrad and Meyer 1958; Fogel and Engerman 1974).

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Even as cliometric history, however, *Child Labor* has defects. There are no formal tests of the research hypothesis. Instead the book purports to identify prices and incomes as the main determinants of child labor by eliminating the competing explanations one by one. *Child Labor* is also weak on quantification. Of course quantification is not essential to the cliometric project, but if the task is to explain changes in child labor over time, it is sensible to begin by establishing trends. So Nardinelli begins with measurement.

Chapter 1 seeks to establish the importance of child labor in the Industrial Revolution without making it appear endemic. Nardinelli's sources are limited to the nineteenth-century censuses and some government inquiries into conditions in factories, most importantly the *First Report of the Factories Inquiry Commission* (1833). Curiously, given his interest in trends in child labor over the course of industrialization, there is no effort to provide benchmark estimates for the eighteenth or early nineteenth centuries. Nardinelli denies that anything can be said about "the initial phase of British industrialization [as] we do not have estimates of the age and sex composition of the industrial workforce" (147). Without estimates of child labor before 1833, trends remain hazy, a fuzziness that is exacerbated by Nardinelli's failure to distinguish child labor generally from children's employment in factories. Was there a boom in child labor throughout the early nineteenth century economy, or did only the *form* of employment change? Nardinelli is clearer about the decline in children's importance in the factory labor force from 1833, but even here, more general trends remain vague.

There has been progress in the measurement of children's work since the publication of *Child Labor* (Tuttle 1998; Cunningham 1996; Horrell and Humphries 1995; Winstanley 1995). This is not an easy task, as children's work was under-recorded, inconsistently measured, and often concealed by the family economy. National census data have to be the starting point (Tuttle 1998; Cunningham 1996; Winstanley 1995), but are not adequate alone. The earliest reliable British census was in 1851, toward the end of the Industrial Revolution. Nardinelli uses 1871 census data even when his interest is in early industrialization. Moreover, all Victorian censuses understate child labor, as comparisons of census enumerators' books with other records show (Gatley 1995). Understatement may have increased in the later censuses, when employers feared prosecution. Carolyn Tuttle's systematic review of the 1851 census evidence contradicts Nardinelli's view. She finds that "children were not merely found in one or two factories at the heart of the industrial cen-

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tres in Leeds and Lancashire . . . but the employment of young people was also commonplace in more rural districts" (Tuttle 1998, 61; see also Winstanley 1995). Tuttle suggests that Nardinelli and others may have underestimated child labor by basing their views solely on the reports of the Inspectors of Factories, which used awkward age groupings and made it particularly difficult to trace trends for those under age 16.

Less traditional sources can complement censuses and employment surveys. Sara Horrell and I (1995) tracked children's contributions to household incomes to identify trends in child labor-force participation in the period before the census. We found that it was in the central phase of the British Industrial Revolution, in the 1820s and 1830s, that children's participation rates were highest. Moreover although domestic industry and mining absorbed significant proportions of the child labor force, it was children's employment in factories that increased most dramatically (Horrell and Humphries 1995, 495; see also Galbi 1995). Finally, on the basis of this recent historical evidence, it appears that Great Britain used child labor more intensively than did other nineteenth-century industrializers and more than do today's poor countries, an observation which has important implications for Nardinelli's analysis, as we shall see.

It would be curmudgeonly to criticize Nardinelli for not anticipating this literature. But he could have tried harder with the sources he used. As it is, *Child Labor* is sharp and controversial about explanation but vague, even sloppy, about what is being explained.

Having eschewed the struggle with quantification, Nardinelli turns in chapter 2 to berate the critics of child labor. Whether contemporaries or historians, Nardinelli charges, they offer moral indignation rather than practical understanding. In (positivist) neoclassical mode, he warns against the passion that the topic has occasioned in the breasts of otherwise calm historians. "The emotional pull of child labor renders it hazardous to attempt a dispassionate study of the practice" (34). "Perspective" is what is missing, a detachment of historian from subject matter hitherto unrealized in historical treatments of child labor. Such detachment is obtained through the systematic consideration of feasible alternatives. Thus, Nardinelli proposes a seemingly innocuous counterfactual. "In the world of the nineteenth century, would the children have been better off had they not been able to work?" (35).

Historians from other paradigms might argue that the detachment of researcher from subject matter that Nardinelli advocates is not possible. Moreover, Nardinelli's own particular "perspective" is far from value

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free. So long as markets are competitive and agents' decisions voluntary, market outcomes will be optimal in the sense described above. Thus orthodox economics has a powerful tendency to endorse the status quo, and the neoclassical economist is inclined to a Panglossian interpretation of events. The reason is that neoclassicism limits the alternatives contemplated. Nardinelli's counterfactual specifies his single alternative: the situation faced by individual families if their children did not work, and with all other things remaining the same. "From the standpoint of neoclassical economics, the decision of working-class families to send their children to work in factories *demonstrates* that they considered it preferable to the alternatives" (155, my emphasis). But is this argument as watertight as it seems? First let us take a closer look at the supply side of this market, and the process of decision making within it.

Chapter 3 presents a stripped-down neoclassical model of the family derived from Gary Becker's New Household Economics. Becker's model extends the notion of the rational allocation of time beyond the traditional dualism, work versus leisure, to the allocation of time by members of a family whose options include a third choice: production in the home. The maximization of family utility yields equilibrium conditions in which, for each pair of family members, the ratio of their wage rates equals the ratio of their marginal productivities in home production, which in turn equals the marginal productivity of the market good they produce at home. Each individual takes on amounts of market and home production that equalize these ratios across all household members. This theory cannot predict a priori an individual's specialization, but those with a comparative advantage in market work, as measured by the wage rate, will devote more time to it than to working in the home.

Nardinelli does not apply the Becker model formally (see, however Horrell and Humphries 1995). Instead he focuses on some partial implications of it. Assume that the tastes of labor-market decision makers did not change during industrialization. Then changes in the allocation of children's time, such as their increased deployment in paid work, especially in factories, must have been their response to changes in prices and incomes—and in particular, to changes in the real wages of children in factory work in comparison with their productivity in the home—because in theory, the real wages for any class of workers in equilibrium will reflect its productivity. Shifts in technology, and specifically the partial mechanization in textile production, rendered children more productive in the early factories and underpinned the early indus-

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trial boom in their employment. Later changes in textile technology reduced the need for children to work in factories piecing together broken threads.

Much of this argument is intuitively plausible. Other historians have concluded that shifts in factory technology increased the demand for child labor in early industrialization (e.g., Bolin-Hort 1989). But they have seen the relationship between child labor and technology as reciprocal. Early textile machinery was sometimes designed for children (Rose 1989), and comparative studies of the cotton industry have shown that similar technologies could be associated with very different workplace organizations and recruitment strategies (Bolin-Hort 1989; Huberman 1996). In the neoclassical model, technology is exogenous. Non-cliometricians prefer to see it as endogenous, even contested: the outcome of an interaction between owners and workers.

The neoclassical assumption that tastes remain fixed is also important. Otherwise, changed outcomes cannot be seen as being necessarily the result of changes in economic variables, such as prices and incomes, but might instead be the product of underlying shifts in (unseen) preferences. By insisting that adults' attitudes toward children did not change, Nardinelli eliminates an alternative explanation for the prevalence of child labor in early industrialization, clearing the way for his economic-productivity explanation. "If basic attitudes and preferences did not change then the changes in the family economy and the economic role of children must be regarded as the effects of changes in technology, prices, and incomes. . . . The household production approach['s] . . . greatest virtue is that it clears up the paradox of the employment of children during the industrial revolution. Instead of being regarded as an anomaly in an era of increased care for children, the employment of children can be seen as a response to changes in wages and shadow wages" (63–64).

While the assumption of stable preferences might be acceptable in certain cross-sections or over short periods of time, the idea that "the basic preferences of English households underwent little change between 1600 and 1900" (63) seems far-fetched. Nardinelli's reference to historic stability in mean household size does not help. Demographic averages can look the same while being driven by very different forces, and stable structures can coexist with shifts in affective relationships (as Nardinelli admits).

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What—or Who—Made Children Work?

The question of who made the economic decisions raises other problems. Cliometricians have imagined the adventures of *Homo economicus* in increasingly unlikely places: here, however, it is *Infans economicus* who is envisaged as responding to market signals. Did children do the choosing and did they, individually, benefit from their labor? How are the preferences of individuals aggregated to form a collective familial ranking? Suppose family members disagree about the best allocation of their resources; whose views dominate?

Becker's solution to such problems is to assume that the husband/father acts as a benevolent dictator. Those critics who see the family as hierarchical as well as altruistic find this solution unhelpful. Understanding the family as itself an allocating institution requires investigating intrahousehold bargaining. Amartya Sen and Bina Agarwal argue that social norms and perceptions of value bear on the intrafamily allocation. The resulting outcome is unlikely to be egalitarian in terms of age and gender.

Most Victorian children were put to work by their parents. Their wages were often paid to their parents. When the family worked as a unit, either in domestic industry or in mines or factories, children's pay was submerged in a lump sum, indistinguishable from the remuneration of other family members. Even when children received their own wages, they were often surrendered intact to parents, who paid back some pocket money. Earning may have raised children's status in the family and secured for them a bigger share of the family's resources. Children may have viewed their contributions as compensation for an earlier period of dependence. Nonetheless, once we recognize that intrafamilial relationships are coercive, both physically and psychologically (through ideas about reciprocity and responsibility), we must challenge Nardinelli's depiction of children choosing to work only if they gained more than they lost. *Families* may have gained, but whether those families were willing or able to compensate children for the costs of their employment remains unclear. Given that these costs could extend far into the future, by means of the adverse effects of work on health or by means of crowding out training, it is not clear that they were really taken into account by parents.

Another characteristic of Victorian child workers makes Becker's model even less relevant. Many of these children were orphans or fa-

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therless (Humphries 1998). They existed *outside* families and were compelled to work by decision makers other than parents, good or bad.

Child Labor as Forced Labor

The first cotton mills were located in isolated rural districts, far from centers of population. Their labor problems were solved by a remarkable fit between their needs and the wish of many urban Poor-Law officials to rid themselves of the increasing numbers of abandoned and orphaned children that the demographic, economic, and military circumstances of the time had combined to produce. Historians have underestimated this flow of forced labor both quantitatively and strategically (but see Rose 1989). This human traffic was organized and systematic. It involved very young and unprotected children. It died out before 1850, but at its peak it involved thousands of children a year. It was a (historically) short-term phenomenon, but those 60 years encompassed the lifetimes of many children. The records of Quarry Bank Mill, where pauper apprentices were used from 1785 to 1847, contain details about nearly 1000 children. Many were illegitimate, while others came from broken families or from families fallen on hard times. Their fathers had deserted their families, joined the army, or been sent to prison. Their mothers had died or abandoned them. They came to Quarry Bank as apprentices in name only. There was no attempt to teach them a trade.

Whether conditions at Quarry Bank were an improvement on the workhouses or homes from which these children came, about 100 appear to have absconded. Many were recaptured, returned, and punished. At the risk of seeming to be "vehement" (34), let me describe a member of Nardinelli's supposedly volunteer labor force, Thomas Priestley, who ran away from Quarry Bank in the 1790s. What motivated this *Infans economicus* to walk 200 miles to London, where he was apprehended and brought before Middlesex Magistrates? The Parish of Hackney had apprenticed Thomas at the age of ten. After three years at the mill, one of the wheels tore off his finger. While recovering from this accident he was tempted to go AWOL. Why? As he testified to the Magistrate: "I thought of my mother" (Robinson 1996).

Pauper apprentices in textile mills stand at one extreme, but many other children's situations differed from that of the "apprentices" only in degree. The children of the poor were poked and prodded into em-

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ployment by family needs and Poor-Law practices. They worked in ignorance of the longer-run effects of their employment on human capital, including health. Nardinelli overlooks the historical essence of child labor, just as earlier cliometricians overlooked the substance of slavery: these children did not have the freedom to exercise choices (on slavery see David and Temin 1975). It is true that working-class autobiographies of the period rarely denounce parents as exploiters, but many recount bitter tales of abhorrent and exhausting work. When they became adults, many such children denounced the economic system, which they perceived had exploited them (see Pickering 1995 and Vincent 1977). Their understanding of the decision to work was not in terms of a Pareto-improving move, but, in the words of one erstwhile child worker, as a "struggle for dear life" (Rymer 1898, 4). Work was preferred to starvation, but only in this reduced sense was it optimal. Recognition that child labor was a response to poverty and inequality puts an alternative counterfactual on the table: marginally less of either or both would have reduced the number of children in mines and manufactories.

Children and Exploitation

In Chapter 4, Nardinelli berates conventional historians for their imprecise and unscientific use of the term "exploitation." An alternative reading of the critics of child labor, including Marx, makes their position more precise, indeed "economic," and goes to the heart of my dispute with Nardinelli: the nature of the alternatives to child labor that need to be considered. The critics of child labor, such as Marx, skeptical about the realism of strong neoclassical assumptions (competitive markets and free choice), anticipated market failures and pursued an implicit cost-benefit analysis of child labor. They argued that the costs, both social and private, were high, and that perhaps the British economy could have industrialized almost as quickly with less child labor, or with more regulations placed on child labor. Their hypothetical alternative to child labor involved higher payments to adult labor and perhaps more poor relief.

It might be objected that this is a "big" counterfactual involving more than marginal changes, especially compared with Nardinelli's own comparative scenario, which holds the "world of the nineteenth century" constant while changing only the extent of child labor. But even

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in his circumscribed counterfactual, if children *generally*, not any one child *individually*, were withdrawn from the labor market (by law), there would have been repercussions for adult pay and prospects, health, education, technology, and growth. In the language of neoclassical economics, there would have been a different equilibrium in the labor market, with general-equilibrium consequences.

Marx, for example, explicitly considered the possibility of multiple equilibria in the labor market. He argued that wages sufficient to support a family could be obtained either by the waged labor of one or two adults, with other family members employed in domestic work and leisure; or through the waged labor of all family members, including children. In the latter case, the family expends more hours of work in the labor market and individual wages fall. Thus, children's employment is associated with lower wages for adults. The withdrawal of child labor would have positive effects on adult opportunities and pay.

These ideas can be represented in a formal model with multiple equilibria in a labor market with child labor (Basu 1999). The aggregate supply curve of labor will depend on the market adult wage. As the adult wage rises, one household after another withdraws its children from the labor force. The result is a backward-bending supply curve of a shifting composite of adult and child labor. With a standard downward-sloping demand for labor, the possibility of multiple equilibria becomes clear. In particular, the economy can be caught in an equilibrium where adult wages are low because children are working. The same economy, however, can be in an equilibrium where wages are high and children do not work. As Kaushik Basu observes, if the economy is in the first type of equilibrium, there is scope for "benign intervention" (Basu and Van 1998). If child labor is banned, the supply of labor is reduced, and if demand stays the same, there will be a new equilibrium with higher wages.

What is interesting is that once the new equilibrium is established, the law banishing child labor is no longer needed, as the new resting point was anyway an equilibrium of the original economy. It is in this sense that the intervention is described as benign. After its initial effect, it becomes dormant and can actually be removed without loss. If this labor market were fitted into a Walrasian model of the entire economy, each equilibrium would be Pareto optimal. From this perspective there would be no way to choose between the general equilibrium with child labor and the equilibrium without it. However, it is possible to show that individual working-class households are necessarily better off

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without child labor (see Basu 1999, 1102). If equality is positively valued, this observation may allow the outcomes to be ranked.

Nardinelli does consider the possibility that adults' wages and children's labor might be related. He compares children's activity rates by county for the 1851 census with E. H. Hunt's (1986) data on male agricultural wages (though something goes badly wrong with the presentation of the latter in Nardinelli's Table 4.2). The relationship is negative but, as Nardinelli emphasizes, rather weak. Tuttle's more recent comparison of the activity rates of children and the wages of adult men in factories in the same local labor markets suggests a stronger negative relationship. Thus, the cotton mills of Aberdeen had the highest activity rate for children under 16 and the lowest average weekly wage for adult males, whereas the silk mills of Derby had the lowest percentage of children working in the factories and the highest relative adult wage (Tuttle 1998, 20–21). Leaving aside Britain for the Netherlands momentarily, Peter Scholliers's detailed study of the Voortman mills in Ghent (1996) shows how competition could involve the employment of whole families at very low pay or else the employment of adults only at higher pay. Similarly, the deployment of child pauper apprentices in the Spitalfields silk industry in Britain was held to have reduced wages, precipitating the Spitalfields Acts of 1773, which restricted the number of apprentices to two per weaver (Rose 1989). My own (1981) work on the 1842 Mines Regulation Act suggests that the wholesale removal of children and women from underground work was associated with an increase in men's pay that was only partially secured through harder and more regular work. Moreover, the range of historical and contemporary experience with child labor as countries develop also hints at the possibility of multiple equilibria in labor markets. Child labor is not always and everywhere an inevitable aspect of industrialization.

Nardinelli's preferred definition of "exploitation" is neoclassical. Exploitation exists if wages are less than their marginal value products, i.e., the value of the output of the last worker employed. Therefore exploitation is, in general, ruled out in competitive labor and product markets, for it is irrational for employers to stop hiring workers when they add more to total product than they cost in wages. Unfortunately, it is difficult to estimate marginal productivity directly, so Nardinelli uses indirect estimates derived from a production-theoretic framework. He then compares these estimates with historical evidence regarding children's pay. The two are sufficiently close to rule out neoclassical exploitation. But the estimates of marginal productivity themselves are

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not independent of wages and prices, so the whole test is rather dubious. Nardinelli is driving a Cadillac down a dirt road; the historical record is not up to testing his elegant theory.

Nardinelli thus falls back on indirect and incidental evidence about exploitation. He compares the health of children who worked in factories with the health of children who did not, with generally favorable results, and he cites evidence of children's mobility to suggest that labor markets were competitive. And he argues that children were compensated through their pay for noxious working conditions. However, he does see apprenticeship as potentially exploitative, as it interferes with a free labor market. Fortunately (in his view) industrialization weakened apprenticeship because it liberated child labor.

While ready to dismiss contradictory material as "anecdotal," Nardinelli's own evidence often includes the testimony of interested parties. Sometimes the logic is dubious. The high turnover of juvenile workers could indicate, as he thinks, the facility with which they swapped jobs, searching for a better match or higher wages; but it could just as well signify insecure employment.

The Factory Acts

Neoclassical economists' tendency to endorse the market allocation leaves them disinclined to champion legislative intervention. In competitive conditions, intervention *must* lead to a misallocation of resources; and even if there are market failures, it remains doubtful whether they can be compensated. However well meaning, state interference likely has more costs than benefits.

Nardinelli believes, moreover, that child employment in factories was already declining before the enactment of protective legislation, and that regulation merely displaced children, who were then forced to work in less productive and probably worse circumstances outside the protected sector. His preferred explanation for the historic decline is the increase in the wages of adult males, which allowed them to purchase more leisure and schooling for their children. Higher incomes combined with a rising demand for higher-"quality" children meant that fewer children worked.

If there is any lesson in this history it is one of complacent reliance on laissez faire (for a broader view see Cunningham and Viazzo 1996). Not only does Nardinelli ignore the possibilities for "benign intervention" as

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described above, but he also fails to recognize the dynamic consequences of child labor. An increase in child labor frequently causes a decline in the acquisition of human capital, producing a generation of adult workers with low productivity that is, in turn, forced to send its own children out to work at young ages. If an economy is caught in a child-labor trap such as this, what is needed is an effort to raise the human (physical and intellectual) capital of one generation, raising their productivity and getting the economy "rolling towards the virtuous equilibrium without need for further action" (Basu 1999, 1108).

Perhaps also there is an inherent inconsistency in Nardinelli's argument. Increased adult wages do over time cause children to be withdrawn from the labor market; the economy converges to a new equilibrium with higher adult pay and less child labor. But he dismisses protective labor legislation, which would surely have put upward pressure on adult remuneration, as a strategy to guide the economy to such an alternative equilibrium.

* * *

Despite the weaknesses in Nardinelli's argument and evidence, *Child Labor* has been widely cited. One reason is the novelty and importance of the thesis. Another is the "shock value" of the findings. A third is the powerful support of neoclassical theory, which makes Nardinelli's position appear impregnable. Remember Nardinelli's counterfactual. In a neoclassical world the children *could not* have been made better off if they had been prevented from working. They had the choice not to work, and they (or their families) had rejected it. *Child labor was revealed (by its existence) as preferred.* The neoclassical argument appears to be closed before the historical record is opened.

There are two alternative views, however. The first is to question the applicability of the neoclassical model to early industrial child labor; the second, to develop the neoclassical model itself in order to consider possible (efficient) alternatives to child labor, and the wisdom or not of intervening in labor markets.

Was the "world of the nineteenth century" neoclassical? The conditions required for market allocations to be optimal are very demanding, and distinguished scholars of general equilibrium are often anxious to point out that these conditions are unlikely to hold even in a modern economy. I do not think early-industrial markets were competitive or that children always (or even often) made meaningful choices with perfect knowledge about their consequences. But whether or not the

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nineteenth century world conformed to the neoclassical model, it was unequal in terms of the distribution of wealth and power. This inequality structured both the possibilities open to child workers and their families, and the outcome achieved in competitive markets. It is possible to contemplate alternative distributions of wealth and power, achieved by lump-sum taxes and subsidies and by regulation, and to trace their implications. Neoclassical economics, in this sense, is not a substitute for normative judgment but provides a framework within which alternatives can be pondered.

Suppose there had been a redistribution of income (more generous poor relief?) or a ban on child labor (protective labor legislation or compulsory schooling?). The associated labor-market equilibrium would have been no better or worse than the equilibrium with child labor, according to the Pareto criterion. But there are other criteria by which to form historical judgments. We might, for example, value equality, in which case outcomes that improved the lot of the poor at the expense of the rich might be preferred. Alternatively, we might value rapid growth, in which case outcomes that prioritized long-term human capital formation might be preferred. A sophisticated use of neoclassical economics does not blindly endorse whatever happened, but allows us to consider other possible outcomes and to weigh their welfare implications, even though some groups lost while others gained.

To claim that child labor was the worst thing that could have happened is obviously wrong. But to insist that child labor was the best thing that could have happened simply because it did happen is equally silly. Nardinelli's vulgarized neoclassical model obfuscates both the suffering and the contribution of child workers. It is time that both were recognized.

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Santhi Hejeebu and Deirdre McCloskey

THE REPROVING OF KARL POLANYI

ABSTRACT: *Karl Polanyi's* The Great Transformation *has had enormous influence since its publication in 1944. In form, this influence has been salutary: Polanyi targets one of the main weaknesses of modern economics. But in substance, Polanyi's influence has been baneful. Mirroring the methodological blindness he criticizes, Polanyi insists on the all-or-nothing existence/nonexistence of laissez faire—and on its all-or-nothing goodness/badness.*

Károly Polányi (1886–1964), who wrote in English after 1935 as Karl Polanyi, was an economic journalist-turned-historian from 1933 to 1939 in England, and from then until his death was a researcher and professor in Canada and the United States. Karl's wife Ilona Duczynska was a physicist and all her life a communist, though she was expelled from the party for anarchistic deviation. In the chaotic style of *Mitteleuropa* between the wars, Karl himself was twice exiled, first from his native Budapest and then his adoptive Vienna. The family were assimilated and secular Jews, of Polish descent (as Pollacsek), a kind attracted to Budapest and New York as the places where Eastern European Jews could prosper at the end of the nineteenth century. His mother Cecile Polányi was hostess of a salon of revolutionary intellectuals in Budapest

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during and after World War I. The Polanyis have produced artists and scientists and intellectuals to the third generation from Cecile. Karl's brother Mihály, Michael, was a distinguished physical chemist in Britain who fell short of the Nobel prize (Michael's son John received it) and a conservative social philosopher. Michael, not Karl, has an entry in Bullock and Woodings's *Twentieth Century Culture: A Biographical Companion* (1983), but this judgment of relative cultural influence is mistaken.

The Great Transformation (1944) is Karl Polanyi's legacy, and it is more durable than most. It tells the story of nineteenth-century capitalism as the rise and fall of market economy: not "a" market economy, in his view, but just "market economy," the very essence. The work was conceived in England in 1939–40 and drafted at Bennington College in Vermont. Bennington at the time distinguished itself with unconventional appointments, such as Polanyi and the literary critic Kenneth Burke. Neither of these had a Ph.D. or indeed much academic training. It makes one wonder about Ph.D.s and academic training.

The Austrian-American management theorist Peter Drucker, another colleague of Polanyi's at Bennington and a fellow émigré, but with a different view of capitalism, was "a source of sustained encouragement" (Polanyi 1944, vi). The Rockefeller Foundation awarded Polanyi a two-year fellowship to write the chief modern indictment of capitalism. Joseph Schumpeter, who liked to point out that "the scheme of values of capitalist society, though causally related to its economic success, is losing its hold not only upon the public mind but also upon the 'capitalist' stratum itself" (Schumpeter 1950b,[1] 448) must have been amused by Polanyi's dealings with Rockefeller. Later, when he was at Columbia, Polanyi's writings against capitalism were financed by the Ford Foundation.

Fifty years after its first appearance, *The Great Transformation* is still being recommended, mistakenly, as a summary of modern economic history. It has never gone out of print. No work of economic history except *Capital* and *The Protestant Ethic and the Spirit of Capitalism* has had more influence.

In the year that Polanyi published *The Great Transformation,* the West Indian historian Eric Williams published *Capitalism and Slavery,* with a theme complementary to Polanyi's, and with a similarly long afterlife. Schumpeter a couple of years earlier had published *Capitalism, Socialism and Democracy*, his economic account of why "a socialist form of society will inevitably emerge from an equally inevitable decomposition of capitalist society" (Schumpeter 1950, xiii). Polanyi's book, like Williams's

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and Schumpeter's, has proven hardy, and the three constitute a triptych of anticapitalist masterpieces.

The Great Transformation is convincing. Sentence by sentence, it is elegant, quotable, authoritative, full of ringing phrases. Though trained as a lawyer, Polanyi was enough of an economist to dispute with Ludwig von Mises in the 1920s on the feasibility of socialist calculation. His main career in the Old World, however, was journalism, and in his only book as sole author he wrote with spirit on the dreariest of topics, from the Old Poor Laws in England to the Fall of Gold.

Economic history never seemed so important. The only appearance of economic historians in literature are the hero in *Lucky Jim* and the anti-hero in *Hedda Gabler* (Ibsen [1890] 1982, 537–8):

> *Hedda*: Tesman is a specialist, my dear Judge.
> *Brack*: Undeniably.
> *Hedda*: And specialists are not amusing traveling companions—Not for long, at any rate. . . . Just you try it! Nothing but the history of civilization morning, noon, and night.
> *Brack*: Everlasting.
> *Hedda*: And then all this business about the domestic industries of Brabant during the Middle Ages. That's the most maddening part of it all.

Polanyi was no maddening specialist. His metaphors burn on the page: "The creation of a labor market was an act of vivisection performed on the body of society" (Polanyi 1944, 127). It is a thrilling book, a detective story as history painting. He took colors from many variants of politics and scholarship, blue to red, and fashioned an alternative to both liberal and Marxian economics.

To overcome the "market mentality" Polanyi urged "the integration of economic anthropology, economic history, comparative economic systems into a comprehensive universal or general economic history" (Stanfield 1986, 32–33). "We shall encroach upon the field of many disciplines," he declares on the second page, and he is true to his word. Polanyi's recipes include nearly every type of human behavior. He would have none of the one-ingredient cookery of conventional economics. As one of his first students at Columbia writes, "He borrowed mercilessly from the entire gamut of the social sciences" (Fusfeld 1988, 268). Polanyi has inspired Marshall Sahlins, Immanuel Wallerstein, E. P. Thompson, James Scott, and Douglass North, to name a few, and has

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given numerous other intellectuals the conviction that in *The Great Transformation* economic history had been grasped.

Polanyi's narrative of the rise and fall of "market economy" is presented as an "economic treatise informed by principles of inquiry very different from those typical of economic analysis" (Lewis 1991, 478). Polanyi was one of the creators of modernization theory, fashionable among academics in the 1950s, a theory challenged in the 1960s and 1970s by economists such as Theodore Schultz and Robert Fogel, who persisted in economic analysis. In premodern societies but not in "market economy," Polanyi claimed, transactions were embedded in community relations. Exchange, in Polanyi's view, follows from three sociopolitical principles—redistribution, reciprocity, and householding—not Adam Smith's "propensity to truck, barter, and exchange one thing for another" (Smith [1776] 1976, 17). Contrary to the Smithian notion that markets are natural, Polanyi argued that market economy was a recent and unnatural intrusion. Markets are not, he claimed, of ancient growth, or the outcome of the expansion of world trade since 1600, or even, for that matter, a natural byproduct of the machine age. According to Polanyi, "There was nothing natural about laissez-faire. . . . Laissez-faire economy was the product of deliberate state action" (Polanyi 1944, 139–41). The deliberation could be reversed.

The free market that ate away human relations, Polanyi said, was brought to life by certain ideologues. It was the societal *response* to market economy that was spontaneous, natural, universal. The self-regulating market induced a "protective response," a widespread movement to reimpose social values on the laws of supply and demand. The "great transformation" looked forward to by the title would be a new world rising from the death of market economy. As Polanyi's student Abraham Rotstein explains, this transformation would be "the reconstitution of an institutional structure that would restore the primacy of social organism over social mechanism and embed once more man's economy within the norms and values of his social existence" (Polanyi-Levitt 1990, 100).

The Marketless World

Throughout the quarter-century or so of his scholarly career, Polanyi searched assiduously for a society without markets that would justify his understanding of "market economy" as a deliberate, idiosyncratic im-

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position. He borrowed first from the work of early twentieth-century anthropologists, whose naïveté about Otherness embarrasses nowadays. Polynesians and early Europeans share with their Native American and Babylonian equivalents, Polanyi believed, a disinclination to gain. He writes: "Broadly, the proposition holds that all economic systems known to us up to the end of feudalism in Western Europe were organized either on the principles of reciprocity or redistribution, or householding, or some combination of the three" (1944, 54–55).[2] Across cultures and for most of human history, he argued, material exchange had meaning far beyond individual want-satisfaction: it affirmed and strengthened the social values of the larger community. Trade occurred, no doubt, but usually not in a manner that would make sense to an economist.

Reciprocal exchange involves ritualized gift giving and receiving. The relations are highly personal: "the right person at the right occasion should return the right kind of object" (Polanyi 1977, 39). The model is politeness among friends. Like the Trobriand Islands as depicted by Malinowski, societies in which reciprocity is prominent usually have low populations and low divisions of labor. *Redistribution*, on the other hand, sometimes occurs even in large economies. "Redistribution obtains within a group to the extent that in the allocation of goods (including land and natural resources) they are collected in one hand and distributed by virtue of custom, law, or ad hoc central decision" (ibid., 40). The models are kingship and socialism. Polanyi asserted that ancient Greece, China, and India, the empire of the Incas, Hammurabi's Babylonia, the New Kingdom of Egypt, and the Dahomey Kingdom of West Africa were all organized on the principle of redistribution. Polanyi's two collaborative volumes with his students, *Trade and Markets in Early Empires* and *Dahomey and the Slave Trade*, make the case for "other allocation systems" in archaic, aboriginal, and precolonial societies, repeating throughout *The Great Transformation*'s claim that "orthodox economic history, in effect, was based on an immensely exaggerated view of the significance of markets as such" (Polanyi 1944, 58).

It is a puzzle how Polanyi could support his claim in the face of four thousand years of price history.[3] But he first wrote before much of it had been published, before Egyptian papyri and especially Mesopotamian tablets had revealed their riches. (One of us was lunching with an elderly art historian, much interested in Mesopotamia; someone noted the enormous volume of clay tablets, about which the art historian complained bitterly that 90 percent of it was rubbish, use-

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less for art history—merely unlimited records from the third ansd second millennia before Christ of the prices of goods and land and labor.)

In any case, when Polanyi confronted a price he saw the record of a culture or a polity as much as of an economy. In early state systems, he claimed, prices were often determined by decrees or administered through royal functionaries. Such rates of exchange were not prices generated by supply and demand. In his well-known essay, "Aristotle Discovers the Economy," he calls prices "equivalences," not market outcomes.

In fact, not just *prices* but *markets* needed to be redefined. Inspired by the work of Henri Pirenne and Max Weber, Polanyi grouped markets into three categories: external (long-distance), internal (national), and local. External markets were places—Polanyi never got over the noneconomist's inclination to think of markets as literal marketplaces, rather than relationships among people in many different places—for long-distance trade, specializing in goods not available locally. "The exchange of English woolens for Portuguese wines was an instance" (Polanyi 1944, 60). A domain of men, not women, external markets in such things as tea or sugar persisted only on the edges of communities, since these goods complemented rather than competed with local goods. Anticipating the idea of "export enclaves" in modernization theory, Polanyi asserted that long-distance trade was "unrelated to the internal organization of the economy" (Polanyi 1944, 58). He supposed that the earliest external markets were, in his terminology, reciprocal rather than emerging, à la Smith, from bartering. "Acts of barter here are usually embedded in long-range relations implying trust and confidence, a situation which tends to obliterate the bilateral character of the transaction" (Polanyi 1944, 61).

Local markets, on the other hand, are embedded in local culture, an outgrowth of Polanyi's third master category, *householding*, the women's realm. "Local markets are, essentially, neighborhood markets" (Polanyi 1944, 63), where women flock to gather provisions for the nest. Of obscure origin and steeped in local customs and taboos, local markets, Polanyi said, are never a substantial part of commerce as a whole. Before 1800 subsistence householding remained the norm for Europe's peasantry. No real market could be expected to emerge from *that*, he said. Despite state backing, mercantilist enterprises could not penetrate the "penny capitalism" of subsistence householding—which in Polanyi's description is irrelevant yet enduring.

In between these two, yet still not the modern market, stands the

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"internal" market, created, in Polanyi's view, by mercantilist legislation. This market seems modern, but only to the naive. Admittedly, "apart from complementary exchanges it includes a very much larger number of exchanges in which similar goods from different sources are offered in competition with one another." But Polanyi resisted seeing such markets as creatures of supply and demand. If a market was not perfect, or was regulated, Polanyi would deprecate its right to be called a market at all. In their pursuit of nation-building, the European sovereigns of the fifteenth and sixteenth centuries may have "freed trade from the confines of the medieval town" (Polanyi 1944, 66); but they merely remade national markets on the town model, as cozy monopolies—hardly, Polanyi would argue, the aggressively expanding markets of the nineteenth century. "This national market now took its place alongside, and partly overlapping, the local and foreign markets" (Polanyi 1944, 66).

Polanyi asserted that none of the so-called markets—reciprocal long-distance, householding local, or mercantilist internal—much resembled the self-regulating market of the nineteenth century. This is why Polanyi wished to argue against the notion that individual acts of barter lead naturally to the rise of local and then wider markets. Gain was not the life force. Since the premodern markets were governed by other principles of economic behavior—reciprocity, reallocation, and householding, all embedded in society and politics—the extent of the market had no automatic tendency to widen.

Polanyi defined and redefined his terms to protect the belief that market economy is historically peculiar. Displaying what Fernand Braudel (1979, 227) called an "almost theological taste for definition," he devised categories of social relationships from which he and his followers believed a new and comprehensive social science could be developed. He suggests that economies past and present might best be understood as instituted goods-moving (again, the market is a literal place). George Dalton called this Polanyi's "positive program," the elaboration of an alternative economics based on "reciprocity, redistribution, ports of trade, and other concepts" (Dalton 1975, 80). By assembling this "theory of sectors, processes, and institutions of actual economies" (Dalton 1975, 79), Polanyi told of an infection that did not spread, the flesh-eating bacterium, "market economy," awaiting its ideological day: around 1800.

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Market Economy as Ideology

Nineteenth-century England is the offstage presence in Polanyi's writing. He wants to explain what caused England to arrive by 1834 at a fully commercial society. Contra Marx, in Polanyi's view the infection did not originate in capitalist modes of production; contra the anti-Marxists, it was not a mutation from the wave of gadgets or of machine production. The plague sprang from the ideology of The Market. Polanyi the historian was an idealist, not a materialist. As Charles Kindleberger (1973, 46) wrote of *The Great Transformation*, "The theme of the book is that it was not industrialization as such which created the social disruption of the nineteenth century, but the notion developed by Ricardo, Marx, and James Mill that markets should prevail." Polanyi devotes a third of his book to explaining how market economy evolved into a legal reality and examining the protective response to the resulting loss of social flesh. Ideas, not classes or gadgets, made modernity.

Polanyi defines market economy as "an economic system controlled, regulated, and directed by markets alone; order in the production and distribution of goods is . . . ensured by prices alone" (Polanyi 1944, 68). It is a rule-driven system that disembeds exchange relationships from their social and moral contexts. The system requires that all commodities, including land, labor, and capital, be traded according to relative prices, set by supply and demand. "But labor and land are no other than human beings themselves of which every society consists and the natural surroundings in which it exists. To include them in the market mechanism means to subordinate the substance of society itself to the laws of the market" (ibid., 71).

Since labor, land, and money are not items produced for sale, in Polanyi's view, they cannot rightly be considered commodities. In particular, the fictitious treatment of labor as a commodity strips man of his "physical, psychological, and moral entity" (Polanyi 1944, 73). This was his root indignation, as it was Marx's: the supposed alienation inherent in a market for labor. Polanyi's parallel indignation about the market's attack on land, the natural world, foreshadows environmentalism, and is another reason for his continuing popularity. Polanyi argues that unregulated market economy, with its rigid rules, commodity fiction, and assumptions of scarcity and selfishness, destroys society. As Rotstein puts it, market economy is a "sociological enormity" (Polanyi-Levitt 1990, 100).

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The system was put into place, Polanyi says, by the intellectual heirs of Adam Smith, utilitarian zealots who believed that "the laws of commerce were the laws of nature and consequently the laws of God" (Polanyi 1944, 117). Consistent with his views of administered trade in olden times, Polanyi cleaves to the idea that ideas matter: the ideologues of nineteenth-century *administered* England's transition to market economy. Liberals like Cobden and Spencer imposed their ideas from above. Writes Polanyi, "The road to the free market was open and kept opened by an enormous increase in continuous, centrally-organized and controlled interventionism" (ibid., 140)—a notion common in the 1940s in the works of American historians like Arthur Schlesinger, Jr., avidly looking for antecedents for the New Deal. Polanyi believed (mistakenly) that cotton manufacturing could not have come to dominate industrial output without the help of protective tariffs, export bounties, and the indirect wage subsidies of the Old Poor Law. The 1830s and 1840s witnessed the crescendo of Benthamite legislation that Polanyi takes as decisive, specifically the Poor Law Amendment Act of 1834, Peel's Bank Act of 1844, and the Anti-Corn Law Bill of 1846. These "three great measures" institutionalized the three great tenets of laissez faire: a competitive labor market, an automatic gold standard, and international free trade. The crux, though, was the market for labor. The market for land, Polanyi argues, evolved over two hundred years of enclosure acts; the labor market was grafted onto English society, in contrast, with a cruel suddenness.

The year 1834 and its New Poor Law was the turning point. Polanyi believed that the end of public charity made possible the establishment of a labor market, which is to say that he did not believe one existed before 1834—not a *real* one, he would have said, against all the evidence of wages paid in England from the thirteenth century to the nineteenth, adduced by scholars from M. M. Postan (1966) to Edward Hunt (1973). Prior to 1834, says Polanyi, if a worker's wage did not afford subsistence, he was ensured survival (in theory) through the Speenhamland law, the 1795 town ordinance supposed to have become a widespread subsidy tied to the price of bread. Polanyi attaches great importance to Speenhamland, on the one hand for the evil of dependency he felt it caused, and on the other for the surety of survival it supposedly provided. He detests it yet mourns its repeal in 1834, which he thinks heralded a greater evil: the competitive labor market. He emphasizes the horrors under the Speenhamland system so as to rationalize why workers might embrace such a market, forfeiting their safety net.

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Inspired by the Webbs (1927), the Hammonds (1911), and Harriet Martineau (1833), and contrary to what has been discovered since he wrote, Polanyi is convinced that Speenhamland reduced rural workers to dependency, in preparation for the final shock.[4] For Polanyi (1944, 98–99) it is unimportant whether workers had been "attracted by high wages or chased from the land by tricky enclosers." He emphasizes instead the displaced villager's transformation into a "nondescript animal of the mire" (ibid., 99). In the countryside under Speenhamland he could at least hang on as some sort of human being. Yet even before 1834 the laborer had already lost his customary status, "a pattern set by his kin or fellows" for which "he could fight and regain his soul" (ibid.). Socially adrift, disembedded, the laborer had lost every incentive to improve his lot. Polanyi writes, "Unless he was able to make a living by his own work, he was not a worker but a pauper" (ibid.).

Polanyi thought the impact of Speenhamland so dehumanizing that a competitive labor market appeared attractive by comparison: "Out of the horrors of Speenhamland men rushed blindly for the shelter of a utopian labor market" (Polanyi 1944, 102). Ideas told. The Poor Law Reform of 1834 replaced Speenhamland with Dickensian work houses. For all their evils, at least work houses sheltered the rural masses from the commodification of labor. Yet "if Speenhamland had overlooked the value of neighborhood, family and rural surroundings, now a man was detached from home and kin, torn from his roots and all meaningful environment. In short, if Speenhamland meant the rot of immobility, now the peril was that of death through exposure" (ibid., 83).

Market Decline: The Double Movement

Social and legal action disarmed the market before it could consume all social relations. The self-regulating market could "annihilate" society, but Polanyi the optimist believed that it had failed. His thesis of the "double-movement" explains how English society escaped the assault, bruised but intact. The antibodies reacted to the flesh-eating bacterium. Polanyi had faith in the recuperative powers of community. As Gregory Baum (1996, 46) writes, "Polanyi held that society was essentially a relationship among persons and that, whenever this relationship was reified or subjected to external forces, people experienced an inner summons to become active in social transformation." The expanding ideology of the market produced immediately a "counter-current" of government

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intervention—the second thrust of the "double movement"— legislation intended not to correct market failures (thus the Chicago School) but to blunt the very functioning of markets. Anne Mayhew (1989) has recently applied this interpretation to Coxey's Army of the Commonweal, the 250 or so unemployed men who marched on Washington in 1894. She thus argues that signs of an American "protective response" appeared early. Keynesian economics, much later, has of course long been viewed as a Polanyi-like societal response to save capitalism from itself. The protective responders demand that the state defend the victims of a ruthless market—overlooking the possibility that such defenses might be the product of the Chambers of Commerce or the Moral Majority; of interests, ideology, or demagoguery.[5] Polanyi's great transformation relies on an apolitical theory of the welfare state, and it is little wonder therefore that a book historicizing this theory was popular in 1944, and since.

Polanyi (1944, 146) dated the demise of market economy to the 1870s, when state actions ranging from workmen's compensation to vaccine laws began filling the need for "safeguarding some public interest against the dangers inherent either in such conditions or, at any rate, in the market method of dealing with them." The double movement appeared in Victorian England, in Bismarck's Prussia, in the France of the Third Republic, and in the Hapsburg empire. By the end of the nineteenth century, Polanyi claims, the domestic side of Europe's market economy was fast crumbling. When England abandoned the gold standard in 1931, the guarantor of international economic stability collapsed, too.

For readers sympathetic to Polanyi's account of the market's rise and decline, the last chapter of *The Great Transformation* offers a benediction: "The passing of market economy can be the beginning of unprecedented freedom" (Polanyi 1944, 256). The folly of nineteenth-century liberalism was its equation of freedom with private property and free enterprise. Polanyi's freedom was that of a Christian Stoic, a latter-day Epictetus. He writes that only in the full resignation to death, to the reality of the soul, and to social bonds can one experience freedom. "Uncomplaining acceptance of the reality of society gives man indomitable courage and strength to remove all removeable injustice and unfreedom" (ibid., 258B). For Polanyi, legislation, planning, industrial tribunals, and guaranteed employment are the instruments of personal freedom, freedom from hunger, freedom from fear itself.

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Polanyi's Reception

Most readers took kindly to the message, beginning with a gushing forward provided by the sociologist Robert MacIver to the first edition. The initial generation of readers was awed, as was MacIver, by Polanyi's "original insights into nearly all the problems of the evolution of social institutions," by his "irrefutable" condemnation of laissez faire, by the way he made the "deep secrets of political economy simple." It was agreed that Polanyi was "on the right track throughout" (Brown 1944, 540; Parkes 1944, 10; *Current History* 1944, 434; Ayers 1943–45, 6). Still, opinion was not unanimous. In 20 reviews of *The Great Transformation* written in academic journals and the popular press between 1944 and 1946, the vote was 13 to 5 in favor, with 2 abstentions.[6]

Most who favored the book found Polanyi's historical narrative compelling. The book provided the educated reader with the impression of getting the lowdown about a field she would rather not study, the economic history of civilization morning, noon, and night (just you try it!). Polanyi's excoriation of the self-regulating market resonated with a then-common distaste for liberal economics. The reviewer for the *Journal of Economic History* hailed the book in these terms: "Persuasively written, the book may well foreshadow the type of interpretation of economic history which will be common if collectivist ideas prevail in the future" (Williams 1945, 124).

The most thorough and soberly sympathetic reading of Polanyi was a book by Alan Sievers in 1949. His *Has Market Capitalism Collapsed? A Critique of Karl Polanyi's New Economics* acknowledges Polanyi's "academic sins" (1949, 363). He faults Polanyi for exaggerating the absence of the profit motive in primitive and archaic societies. Concerning Polanyi's repeated denunciations of Smith's paradigm of the bartering man, Seivers (1949, 316) replies:

> Smith's edifice does not really depend on the historical validity of his assertions concerning the bartering habits of primitive man. The relation which Smith saw between division of labor and exchange was not merely historical but also analytical, and indeed the dependence of the division of labor upon the extent of the market is a more important doctrine in his system than the historical dependence of the division of labor on the universality of barter.

In his obsession with disproving the universality of barter based on self-

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interest, Polanyi misses Smith's larger point that the degree of the division of labor depends on the size of the market.

A further non sequitur is at work in *The Great Transformation's* attack on *Homo economicus*. How exactly did the historical oddity of the motive of gain result in satanic mills, environmental decay, and the "troubles of the modern age" (Sievers 1949, 332)? Polanyi does not tell us, says Seivers. Never mind about the historical record. For Polanyi it suffices to pummel the bartering man beyond recognition.

As early as 1949, Sievers had the materials at hand to criticize Polanyi's handling of British economic history. He catalogues Polanyi's chronological errors, his tendency for implicit analyses, his impressionistic evidence, and his abandonment of systematic method in favor of the essay. As Polanyi was writing, economic historians such as Thomas Ashton, Walt Rostow, and Alexander Gerschenkron were bringing a new economic precision to the study of the past. The evidence since 1949 has been crushingly anti-Polanyian.

Sievers acknowledges the sin, yet forgives. He views *The Great Transformation* as a masterwork in the social sciences. As have many others. Polanyi the man/the book was loved for his/its interpretive genius. Abraham Rotstein describes the effect of listening to Polanyi at his country home outside Toronto: "In the Toronto metropolis . . . I read the world news. . . . But in Rosebank, I heard Karl explain what it all meant. . . . With his extraordinary antennae he picked up the travails of the twentieth century and the rumblings of the planet" (Polanyi-Levitt 1990, 98). He made the random century cohere.

Polanyi was Right

Polanyi was certainly right about the anxieties of his time. The long peace, the gold standard, the market, the liberal state, he says on the first page, seemed one with Nineveh and Tyre. With a handful of democracies surviving and two decades of economic chaos concluding, it looked plain common sense to say that "every vestige of the international system had disappeared" (Polanyi 1944, 23), because it had. That it could be rebuilt seemed then impossible, as impossible as economic recovery from the War. True, the impossible occurred. The peace since 1945 approaches 1815–1914 in grandeur. The gold standard was reinvented as the dollar standard, and now as a commitment to hard currencies generally. The market has spread, the liberal state is triumphant.

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Polanyi's predictions on these scores were quite wrong. But in 1944 his predictions were no worse than others. The economics profession, for example, was convinced that the Great Depression would resume after the War. As late as 1989 one could have thought, and many Sovietologists did, that the illiberal empires were here to stay.

One can argue that a demoralized capitalism was saved precisely by the "double movement" in Polanyi style, that the welfare state saved capitalism by replacing it. It was Keynes's hope in 1944. This argument, like many Cold War truths, seems less believable now, but it is hard to know what would have happened otherwise; and in any case, the long experiment in state activism that Polanyi dates to the 1870s is hardly finished. The share of national expenditure consumed by the state has gone down in no country since 1945.

Polanyi was certainly right, too, that demoralization about capitalism started a century earlier, at any rate among the intelligentsia. As George Bernard Shaw ([1912] 1990, 334) observed:

> The first half of the XIX century considered itself the greatest of all centuries. The second discovered that it was the wickedest of all centuries. The first half despised and pitied the Middle Ages. . . . The second half saw no hope for mankind except in the recovery of the faith, the art, the humanity of the Middle Ages. . . . For that was how men felt, and how some of them spoke, in the early days of the Great Conversion, which produced, first, such books as the *Latter Day Pamphlets* of Carlyle, Dickens' *Hard Times* . . . and later on the Socialist movement . . . which has succeeded in convincing even those who most abhor the name of Socialism that the condition of the civilized world is deplorable.

The Great Conversion took decades to spread beyond a handful of avant-garde intellectuals. Popular literature from the Horatio Alger stories to Dale Carnegie and *The Reader's Digest* continued to reflect on bourgeois virtue. Yet the intellectuals won in the end, as they do. By 1944 their views had passed into the commonplaces that are smoothly summarized in *The Great Transformation*. Ideas do rule, as Polanyi's triumph shows.

And one of Polanyi's main points, somewhat surprisingly, can be defended rigorously. He says of enclosures, for instance, "the usual 'long-run' considerations of economic theory are inadmissible; they would prejudge the issue by assuming that the event took place in a market economy" (1944, 37). And: "In no case can we assume the functioning of market laws unless a self-regulating market is shown to exist" (ibid., 38). An economist reading such sentences—and they are very frequent

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in the book—is at first merely irritated. Just ignorant anti-economic muttering, she mutters to herself. The economic historian Witt Bowden (1945, 283) advised the economist to curb her annoyance and finish the book. If she does, she takes thought, and it eventually occurs to her that Polanyi's point is not so ignorant after all. The rigorous way to put it is that an economy without every market functioning does not present its participants with the correct relative prices. It is the same point made by Coase in 1960, Lancaster and Lipsey in 1956, Arrow and Debreu in 1954, Rosenstein-Rodan in 1943. Polanyi writes, for example, that "for the merchant this means that all factors involved must be on sale" (1944, 41), which is to say that markets must be complete. Polanyi's point is identical to the (So-Called) Coase Theorem. The (So-Called) Theorem (it is not what Coase had in mind as his contribution, but it is what has been universally attributed to him) is that if markets are perfect, nothing need be done. Coase meant this old and mathematical proposition in economics to be used as an absurdity only, to show that in any real world something does urgently need to be done, such as defining private property better. Polanyi has the identical *reductio* in mind. Coase and Polanyi differ only in what they want done: Coase wants more markets, Polanyi fewer.

The same point is made in the General Theory of the Second Best of Lancaster and Lipsey. Are you serious about proving that some removal of monopoly or other obstruction to a market is good? Well, then, it better be true that the First Best is in fact achieved in every market, for otherwise you can't say anything with only a blackboard and a piece of chalk. It is Polanyi's rebuttal to a priori claims about good markets. The same point is made in Arrow and Debreu. Are you serious about proving the invisible hand is beneficent? Well, it better be true that a market in every conceivable contingency into the indefinite future should exist, or else you can't prove it. Or Rosenstein-Rodan. Are you serious about capitalist investment being the best possible allocation of funds? Then you'd better already be in a capitalist paradise. Polanyi's valid point was that before 1834, no one was in such a paradise, that for a quarter century the English tried to be, and that by the 1870s they and others had abandoned the attempt.

History on the Altar of Proof

Vindicating Polanyi as a theorist, however, at the same moment (a

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"double movement") damns him . . . as a theorist. Like many economists since Ricardo, Polanyi thinks that by pointing out the absurdity of trying to vindicate "the market economy" a priori, he has—a priori—condemned it. Since non-absurd, real-world markets are imperfect, they should be dispensed with or regulated. Since the laissez-faire economist cannot soundly make his case with chalk on blackboard alone, he cannot make it at all. Polanyi desires proof where measurement is needed. The desire has ruined modern economics, and Polanyi, the great anti-economist and eager student of the historical record, shares in the disaster.

For example, he claims that before the nineteenth century, people lived in a "gainless economy" (Polanyi 1944, 49). Now in one restricted sense this is obviously correct: the restricted sense of ideology and of intellectually history. The intellectual historian Allan Megill is fond of distinguishing "Think" History from "Do" History, the history of how people thought and felt, which depends heavily on techniques of interpretation, as against the history of how they acted, which depends heavily on massed observations. The one is literary and anthropological; the other quantifying and economic. As Think History it is true that the ideological supports for the profit motive altered dramatically between, say, 1600 and 2000. But as Do History there is something wrong. The ways of showing the wrongness are myriad.

Take down from the shelf Thomas Tusser's *Five Hundred Points of Good Husbandry,* published about three centuries before Polanyi reckons that the pursuit of gain first dominated. In lines 1 and 3 of "The Authors Epistle," on the first page of the book, you read, "Time trieth the troth, in everie thing, / . . . Of works, which best may profit bring." And so for 200 pages of doggerel, saturated with Think History remarks on gain, as in Chapter 51, "Ill husbandrie selleth/ his corne on the ground;/ Good husbandrie smelleth/ no gain that way found. . . . Ill husbandry lieth/ in prison for debt:/ Good husbandry spieth/ where profit to get" (Tusser [1573] 1984, 1, 132–33). A world in which people did not, in the current argot, "do gain" could hardly generate such gain-focused thinking.

Another example of the same sort: "Previously to our time," Polanyi (1944, 43) says, "no economy has ever existed that, even in principle, was controlled by markets. . . . Gain and profit made on exchange never before played an important part in human economy." Cicero was previous to our time, and lived in an economy that existed. Take down the volume of letters between him and his friends, and open them at ran-

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dom. Quintus Metlus Nepos to Cicero, from Spain, 56 B.C., "I have written fully to Lollius, telling what I want done about my provincial accounts," his gain and profit there (Cicero 1927, V.iii). Cicero to Publius Sestus, December 62 BC: "I have now bought that very house for three thousand five hundred sestertia . . . . The consequence is that I am heavily in debt," an odd situation for someone in an economy markets did not control, and in which gain and profit played no important part (Cicero 1927, V. vi). This in a member of the senatorial class forbidden officially to deal in profit and loss. The ideology was anti-market, but Cicero's life was immersed in markets.

The important word in Polanyi's declaration that gain and profit made on exchange never before played an important part in human economy is "important." Polanyi acknowledges the bare existence of markets before 1800. But he emphatically denies their significance. In the numerous repetitions of the claim he commonly puts it quantitatively: "no economy prior to our own [was] even approximately controlled and regulated by markets" (Polanyi 1944, 44). How much market? How much profit, gain, Prudence in terms of Price? Polanyi implies: nil. But this qualitative implication is fudged by the quantitative caveat, "approximately."

Before the nineteenth century, Polanyi proclaims from his blackboard, people lived in a "gainless and marketless economy" (1944, 49). Now it's one thing to assert that the ideology of gain altered; to some large degree it did, and to a remarkable and even bizarre degree. What he says is true as Think History, though hardly original. Bourgeois virtues have many more defenses in 2000 than they had in 1600. We have known that for some time. But it's quite another matter to assert that in fact people in olden times were not motivated by gain. As Do History the assertion is wrong. It would be like saying that before Galileo, a falling stone followed Aristotelian rules. The ideology of falling stones, the Thinking that people did as they watched them fall, changed. But the behavior of the stones did not. Or at any rate one needs to inquire earnestly into the evidence as to whether it did, and if so, by how much.

A corollary to Polanyi's claim of a "gainless and marketless economy" is the notion that state action created the "free market." He imagines that administrative fiat can turn a free market on like a light switch. Once the switch is on, Polanyi believed that any regulation whatever obviates a market. An epsilon degree of social intrusion, as a social mathematician might put it, makes for No Market. Off again. A mistake

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that Polanyi and his school repeatedly make is to suppose, without evidence, that the free market is a discrete function of government action. This is a non sequitur based on a simplistic understanding of what laissez faire means.

Smith viewed the market as a continuous function of the interactions among disparate buyers and sellers. The interactions are hindered by many forms of government involvement and aided by certain others, such as a legal framework that ensures property rights. Smith's market is an elaborate construct girded by numerous trusses and spanning many types of what are today called market structures. By contrast, Polanyi's "free market" is first engineered by Benthamite legislation of the 1830s and 1840s; the "protective response" of the 1870s then demolishes it. Polanyi's standard is again that of Arrow-Debreu—flawless markets or nothing.

That standard is of no use for scientific investigation. We need to know *how much* regulation kills a market. The presence of regulation does of course change the relative prices, the Hayekian signals. But the question is, How much? In China at the height of the Cultural Revolution, the women of the villages secretly purchased produce from the farmers and fishers before the watchmen began their call. Supply and demand popped up in the unlikeliest place.

Theorizing—Polanyi's or "Coase's" or Arrow and Debreu's—has its use in suggesting where to look for evidence. The evidence certainly does not speak for itself. To speak, it needs generalized terms and posited relationships: a theory—a sort of grammar of evidence. When the classicist H. L. Heichelheim, for example, criticized Polanyi's interpretation of cuneiform and Greco-Roman evidence by holding it up against a theory-free standard, Polanyi (in Dalton 1968, 258) replied reasonably:

> Still another instance of Heichelheim's practice of "no theory" should perhaps be adduced. The methodological device of transcending time-bound institutions through the introduction of generalized terms was applied by me throughout the work. In order to avoid the marketing connotation of "price" where inappropriate, a new term . . . was introduced . . . which would apply irrespective of the pattern of integration.

Polanyi, however, sought a "generic economic science which accounts for all human economies" (Sievers 1949, 36–37). Such a programmatic goal could have appeared in th'to Polanyi's time, Lionel Robbins. It was

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typical of mid-century positivism in the social sciences. Polanyi's positivism sharpened during his years in Columbia's economics department, as a comparison of *The Great Transformation* with the later *Trade and Markets in Early Empires* makes clear. Polanyi attempted a science of institutions. But like other more recent attempts, such as Douglass North's, he instead created a set of definitions that assured that his new science could not be refuted by history.

The bulk of historical inquiry into the matter has refuted Polanyi's assertions about Do History. The doyen of African economic historians, Philip Curtin, for example, offers ample evidence that African economies before and during European contact were price economies. About Polanyi's notion that Dahomey was a "port of trade," which is to say a government-monopolized and non-market entrepôt, especially in slaves, Curtin (1984, 58) writes: "Later research has shown, unfortunately, that Polanyi misunderstood the evidence. The state did not have a monopoly over the slave trade. Rather than being administered, the economy as a whole responded to market considerations with roughly the same social and economic complexity that might be found in early European market economies."

Curtin (1984, 83–84) gives a striking example from an economy even more remote from English capitalism's taint: Raymond Sidrys and his team of archaeologists measured the ratio of the cutting length to the weight of obsidian blades produced by the Classic Mayans before 800 A.D. If Mayans lived in a gainless, profitless, nonmarket economy, it would not matter to them how expensive obsidian was. But Sidrys and company found that the ratio varied inversely with the distance from the sources of the obsidian. By taking more care with more costly obsidian, the blade makers were earning better profits, as they did by taking less care with less costly obsidian.

The assyriologist Daniel C. Snell (one of many students of the ancient Near East who has found Polanyi's notions of a gainless, profitless, marketless economy unpersuasive) analyzed a set of prices from 2044 to 2030 B.C. in southern Mesopotamia, and concluded that there was little evidence of "administered" prices, or, in Polanyi's terminology, "equivalences" set by governments rather than markets. As Curtin (1984, 70) emphasizes, "All later authorities [later than Polanyi] . . . portray an economic order [in Mesopotamia] where merchants were extremely sensitive to small changes in price [thus the masses of correspondence on clay tablets providing instructions for buying and selling items like copper], where price fluctuated

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rapidly, and where authorities interfered . . . —but never to the extent of successfully suppressing the underlying play of supply and demand."

In case after case in the history of Polanyism, in one academic field after another, an initial enthusiasm has ended in yet another demonstration that the market pops up if your theoretical categories allow you to see it (Curtin 1984, 57–70; Latham 1996, 8–14; Chaudhuri 1985, 223–28; Braudel 1979, 225–29; Veenhof 1972, 345–57; Snell 1991, 129–41; Silver 1983, 795–829). Currency in olden times turns out to be in fact for "general purpose"; port trade was not, after all, administered. In such a matter, to repeat, not "proof" but only magnitudes matter: *how close* to a perfect market economy does an actual economy have to be before the long-run considerations are to this or that degree admissible? *How much* of a self-regulating market needs to exist before we can assume "approximately" the functioning of market laws? It is not a matter of on/off, exist/not. Capitalism is not like a theorem, a statement true or false. It is like a bridge more or less stable.

Prudence vs. Solidarity

What is left of Polanyi's legacy if his history is hopelessly mistaken as to magnitudes, as it is?

In matters of method, modern economics would do well to relearn Polanyi's lesson that (of course) an economy is embedded in a society. All behavior is embedded in ethics, the language and culture of a commercial, or an anticommercial, society. At the heart of Polanyi's continuing appeal is his honoring of a more complex ethical system than is covered by the virtue of prudence, or utility, alone. Explicitly reckoning with a broad range of human motives, he gives his readers an ethical vote.

In answering "how much market," counting, the search for convergences and correlations of prices, must be done.[7] But this—positive science—is a mere beginning. Do History alone, the positivism that Karl's brother Michael (1962, 88) described as "voluntary imbecility," is not the whole. Polanyi recognized this, but he went too far in the antipositivist direction in his search for blackboard theories with which to smite laissez faire, which seemed to him to be premised on blackboard theories alone.

The official rules of polite conversation in economics since Jeremy

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Bentham insist on reducing behavior to a narrow construction of "observable implications" and treating *all* behavior as emanating from prudence, that is, self-interest. If only "observable implications" are to matter, and if you do not look too deeply into what an observation is, the program works, at any rate as a device for publishing papers and attaining academic tenure. If you do not view the stories people tell as "behavior," you can go on believing that people are a good deal like experimental rats. Polanyi objected to all of this. It was his skill and his charm. But he substituted one chalkboard construct with another.

Jeremy Bentham cannot be blamed for the imbecility of, say, statistical significance. That is a late-twentieth-century failure of the positivist program. But Bentham is the source in economics and its imitators of treating all behavior as Prudence alone. Bentham and his heirs, such as the economists George Stigler and Gary Becker, the late sociologist James Coleman, and the federal judge Richard Posner (all of these gathered at the University of Chicago), assure us that Prudence alone is enough to explain everything. Just everything. Bentham's *Principles of Morals and Legislation* (1789, 146) called Prudence by the word *utility*, and claimed to prove that "the only right ground of action that can possibly subsist is after all the consideration of utility." Faith, Hope, and Love, to the Benthamite or Beckerian mind, are Prudence in another dress.

Adam Smith knew better, and said so at length. Smith created an ethical system for the middle class, following the precept of his friend David Hume, that "Readers as are plac'd in the Middle Station. . . . form the most numerous Rank of Men, that can be suppos'd susceptible of Philosophy, and therefore all Discourses of Morality ought principally to be address'd to them" (Hume [1742] 1985, 546). Smith's *Theory of Moral Sentiments* discusses five of the seven cardinal virtues. The Pagan Four are: courage, temperance, prudence (or wisdom), and justice. The Christian Three are faith, hope, and love—but Smith left out faith and hope as dangerous to a commercial society (faith and hope in fact proved to be very dangerous indeed in their nineteenth-century forms of nationalism and socialism). The five remaining can be arranged on a spectrum, from aristocratic through bourgeois to Christian:

Courage Temperance Prudence Justice Love

Prudence was the central ethical virtue of the bourgeoisie, with Temperance on one side and Justice on the other. Smith's book about pru-

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dence, *The Wealth of Nations*, should be read as embedded in the other virtues, especially temperance and justice, about which he wrote at length (he was uncomfortable with both courage and love, as tending to non-bourgeois excess).

Polanyi read *The Wealth of Nations* as open to social purposes. He writes of Smith: "Wealth was to [Smith] merely an aspect of the life of the community. . . . The economic sphere, with him, is not yet subject to laws of its own that provide us with a standard of good and evil" (Polanyi 1944, 111–112). He saw Smith correctly, in other words, as a social embedder. Polanyi aimed his attack at a Benthamite and nineteenth-century corruption of Smith, the reduction of all virtues to one.

Had Smith had been econometrically inclined he would have put it this way. Take any sort of behavior you wish to understand—voting, for example, or the scattering of plots in open fields, or the adoption of the Bessemer process in the making of steel. Call it B. It can be put on a scale and measured; or perhaps it can be seen to be present or absent. You want to give an account of B. What Bentham claimed is that you could explain B with a single variable, P—prudence, price, profit, the Profane. Polanyi replied that, no, you have forgotten love and courage, justice and temperance, in a word, Solidarity, the S variable of speech, stories, shame, the Sacred. Economists have specialized in P, sociologists in S.

What Smith said is that of course most behavior, B, is explained by both P and S:

$$B = \alpha + \beta P + \gamma S + \varepsilon.$$

Like Alfred Marshall's scissors of supply and demand, resolving in the late nineteenth century the long and pointless quarrel between supply *or* demand as *the* determinant of price, including both P and S is only sensible. It is not wishy-washy or unprincipled. *Of course* the S variables are the conditions under which the P variables work, and the P variables modify the effects of the S variables. The present-day institutionalist John Adams speaks of the market as an "instituted process," which is exactly correct. The institutions are the S, the process the P, or sometimes the other way around: anyway, both.

Econometrically speaking, if the P and S variables are not orthogonal, which is to say if they are not entirely independent, or alternatively if there is reason to believe that a variable such as PS has its own influence, then an estimate of the coefficients α and β that ignore S (or PS)

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will give biased results. The bias is important if the S variable is important. What Polanyi argued was that the S variable *was* only important "before market economy." In this he was wrong, but in a surprising way: it is important early and late, in recent market economies as much as in supposed "non-market" economies of redistribution or reciprocity.

One can give unlimited instances. The econowannabes in American departments of political science, for example, are much taken with "rational-choice models" of voting. People vote their pocketbooks. They throw the lever for the Republicans if the Republicans outbid the Democrats in offering tax cuts. People are Republicans for reasons of prudence, not because they are persuaded it is just to reduce the capital gains tax, or because courage requires them to stand up against creeping socialism, or because it seems a temperate move to throw the lying Democrats out, or because they love Ronald Reagan. $B = \alpha + \beta P + \varepsilon$. No S variables about it.

But the economists who invented this sort of thing, such as Anthony Downs and George Stigler (and Karl Marx, for that matter), knew that there was something peculiar at the heart of the argument. One of us had a bizarre quarrel with Stigler about it in the billiard room of the Quadrangle Club at the University of Chicago, around 1978.

Stigler: As Downs showed, people vote their pocketbooks. They are rational in voting.

McCloskey: But, George, they have to be crazy to come to the polls in the first place. One person's vote in a large election has virtually zero effect, so it would be imprudent to expend effort in troubling to get to the polls. That, too, is an implication of Prudence. As you show in your textbook *The Theory of Price* (1966, 90, 200), it is irrational for a single actor on a large stage to expend any effort, since he has no effect on the tableau.

Stigler (annoyed): All that matters are the empirical implications of the model.

McCloskey: You mean that if it is an empirical implication of an argument that A and not-A are both true, nothing is wrong? The behavior in question is going to the polls in the first place. That's empirical too, isn't it, George? The pocketbook, P-variable theory of voting is a theory of the rationality of madmen.

Stigler (intensely annoyed, striding off): The empirical implications! Positivism! Behaviorism! (He exhibits a cross, warding off the Devil.)

Most economics and most sociology is persuasion about the mixture of prudence and solidarity that matters in any particular case. Only in

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theory, a poor theory at that, are economists besotted with prudence. Without making it explicit, economists are considering solidarity all the time. Theodore Schultz argued in *Transforming Traditional Agriculture* (1964) that peasants in poor countries were prudent. He was arguing that it was a mistake to explain their behavior as $B = \alpha + \gamma S + \varepsilon$ alone. But he did not ignore the S variables. Educating women, he argued, was crucial in making prudence work, and doing it would depend on overcoming patriarchal objections to literate women. Robert Fogel and Stanley Engerman argued that American slavery was prudential and capitalistic. But they did not ignore the S variables. They measured them by indirection, finding that for some features of slavery, such as the price of slaves, variables other than business prudence were not very important. Fogel went on to write about the influence of religious belief on slavery and abolition, and Engerman to write about the historical roots of coercion and freedom in the labor market.

It is only in the fever of blackboard composition that economists forget S. Gary Becker forgets S as a matter of behaviorist principle, not because he actually believes that people do not love one another, or exhibit courage (even in their scholarship). Economists and especially cliometric historians actually spend most of their time investigating the salience of S variables. Studies of open fields, the Industrial Revolution, free banking, innovation in farming and manufacturing, the country store, the company town, Chinese agriculture, New Deal politics, and so forth are studies of institutions—seen through a lens of prudence, to be sure. Thus Douglass North's peculiar olive branch to Polanyi, an indictment of the cliometric history he fathered. "If his [Polanyi's] spirit does not haunt the new economic historians," North wrote, "it is only because they probably are not even aware that the ghost exists" (North 1977, 704). New economic historians have been studying institutions all along.

But it is equally mistaken to rely on S alone, and to reject P. That is what Polanyi does, and that is what is chiefly wrong with his book. At one point Polanyi gives an evolutionary argument showing that narrow prudence is unnatural (*pace* E. O. Wilson):

> The individual's economic interest is rarely paramount. . . . The maintenance of social ties, on the other hand, is crucial. . . . Such a situation must exert continuous pressure on the individual to eliminate economic self-interest from his consciousness. . . . The premium set on generosity is so great when measured in terms of social prestige as to make any

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> other behavior than that of utter self-forgetfulness simply not pay. (Polanyi 1944, 46)

This argument is not very good biology, part of the long tradition in the social sciences of appropriating Darwinian arguments mistakenly. Polanyi claims for the sake of argument that prudence can be reduced to considerations of solidarity. In any event Polanyi's biology shows how deeply he regarded capitalism as artificial, unnatural, an episode, a world we should be glad, in 1944, to have lost.

Error and Understanding

Polanyi's passion for the non-market ways of reciprocity, redistribution, and householding led him to unreasonable skepticism about the scope of markets. In the end neither he nor his followers ever found the Isle of the Blessed, a past without markets. As Polanyi's great friend Peter Drucker (1979, 138) (a great friend of markets, too) put it:

> The more Karl delved into prehistory, primitive economics, and classical antiquity, the more proof did he find for the hated and despised market creed of Ricardo and Bentham, and also of Karl's contemporary bogeymen, Ludwig von Mises and Friedrich Hayek of the Austrian School. So Karl retreated into footnotes, into more and more anthropological studies, and into academic busyness.

Blinded by what his wife called his "sacred hate" (Polanyi 1977, xvi) of market society, Polanyi would have regarded prudence as an ethical nullity. Such hatred is unexpected from an intellectual once impatient of Hungary's feudalism and of a family riven by an excess of German solidarity. To his credit he sensed that he was wrong. Polanyi in his later writings understood: "If we can then find trade determined by the price differential obtaining between goods, we can speak of market trade" (Polanyi 1977, 136). Polanyi can be numbered among the unusual academics who have changed their minds about anything. He improved with age.

Polanyi's experience in the 1950s appeared to assuage his hatred of capitalism, but the sins of the father fell on the sons and daughters. Polanyi's "obsolete anti-market mentality" continues to exclude his followers from the conversation of mainstream economics. He did not live to engage the controversies arising from his analytical concepts. By the

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late 1960s George Dalton and others in the Polanyi Group were left to defend the master. The intellectual battle took place in economic anthropology, rather than in the economics or economic history where Polanyi began.

It's a pity. For all its defects, *The Great Transformation* could induce economists to take stock of Benthamism, and perhaps recognize its voluntary imbecility. It can help them turn from their current conversation of imbeciles toward a better and fully embedded economic science.

NOTES

1. This was the essay Schumpeter was working on the day he died.
2. Polanyi (1957, 1977) later grouped householding as a special case of redistribution and included "market" as a third type of "economic integration."
3. The earliest collected price series begin in 2044 B.C.E in the southern Mesopotamian city of Umma. See Snell 1982.
4. Actually neither the Webbs nor the Hammonds accorded Speenhamland the importance Polanyi attached to it. As the American institutionalist C. E. Ayers wrote, "Even the Hammonds, whom he [Polanyi] counts as his chief supporters on this point, specifically condemned the Poor Law Commissioners of 1834 because 'they could not take their eyes off the Speenhamland goblin.' *The Village Labourer*, p. 231." Nor did later studies (Blaug 1963 and McCloskey 1973) of the Old Poor Laws portray Speenhamland as the watershed represented in *The Great Transformation*.
5. See Thomasberger in Cangiani 1997, 61 and Bartel 1994. Polanyi never questions, as feminists point out, the gendered and hierarchical nature of the society being "protected." See Waller and Jennings 1991. Block and Somers 1984 endow "Polanyi's theory of the state" with a cogency not found in the text.
6. Favorable reviews appeared in the *Annals of the American Academy, Canadian Forum, Current History, International Affairs*, the *Journal of Economic History, The New Republic*, the *New York Herald Tribune*, the *Political Science Quarterly*, *Social Studies*, and the *Southwestern Social Science Quarterly*. Mostly favorable reviews appeared in the *American Economic Review, The Nation*, and the *New York Times Book Review*. *Library Journal* and *The New Yorker* ran neutral reviews. The *American Historical Review* was mostly unfavorable. Negative reviews were published by the *American Catholic Sociological Review*, the *Christian Science Monitor*, the *Journal of Political Economy*, and *Survey Graphic*.
7. It is of course being done with much illumination. Larry Neal's work (1990) on capital markets of the eighteenth century and Jeffrey Williamson's analysis (1995) of factor-price equalization in the nineteenth century are but two cases in point.

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Shyam J. Kamath

INDIAN DEVELOPMENT AND POVERTY: MAKING SENSE OF SEN ET AL.

ABSTRACT: *The work of Amartya Sen and his collaborators on Indian economic development compares three Indian states so as to demonstrate the superior performance of interventionist, left-wing governments in West Bengal and Kerala compared to the more typical state of Uttar Pradesh. A careful analysis of the evidence, however, shows that Sen et al. ignore the anti-interventionist implications of their own evidence of corruption in the state of Uttar Pradesh; dramatically overstate the success of leftist governments in West Bengal; and overlook the role of Kerala's culture and its private education system in accounting for its famously high levels of literacy and female independence.*

Amartya Sen, the Indian-born economist, was awarded the 1998 Nobel prize in economics. In the citation for the award, the Royal Swedish Academy of Sciences (1988) stated that the award was given for Professor Sen's contributions to welfare economics in the fields of social choice, welfare distribution, and poverty. The Swedish Academy summarized his contributions in this manner:

> Amartya Sen has made several key contributions to the research in fundamental problems in welfare economics. His contributions range from axiomatic theories of social choice, over definitions of welfare

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> and poverty indexes, to empirical studies of famine. A general interest in distributional issues and a particular interest in the most impoverished members of society tie them closely together. Sen has clarified the conditions which permit aggregation of individual values into collective decisions, and the conditions which permit rules of collective decision making that are consistent with a sphere of rights for the individual. By analyzing the available information about different individuals' welfare when collective decisions are made, he has improved the theoretical foundations for comparing different distributions of society's welfare and defined new and more satisfactory indexes of poverty. In empirical studies, Sen's applications of his theoretical approach have enhanced our understanding of the economic mechanisms underlying famines.

Clearly, Professor Sen's contributions have covered a wide canvas. This paper will limit itself to critically examining Sen's work in the area of development economics pertaining to the Indian experience. Even though such an assessment should ideally cover Sen's seminal contributions to the economic analysis of famines, that would require a separate full-length treatment.

My topic, then, is one specific aspect of Sen's work on Indian economic development, as contained in the volume he edited in collaboration with Jean Drèze: *Indian Development: Selected Regional Perspectives* (Oxford University Press, 1996), hereafter abbreviated as *IDSRP*. An examination of this book raises a number of questions about the work of Sen and his collaborators, and whether it merits all the praise it has received from academics and policy makers. *IDSRP* will be used as a jumping-off point, then, for assessing the contributions of Professor Sen and his collaborators to the economics of poverty and development.

In order to contrast the successes and failures of Indian development policy in the post-independence era, *IDSRP* brings together a series of papers that contrast the developmental records of three major Indian states that have had divergent development paths. These three states are Uttar Pradesh (the "failed" state), West Bengal (the "transforming" state), and Kerala (the "success story" state). Questions of mortality, fertility, and gender bias are taken up in a separate chapter. The authors of these four separate chapters are all development economists or social scientists (Drèze is a coauthor of two of the four regional-perspective chapters); an opening chapter entitled "Radical

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Needs and Moderate Reforms" by Sen lays out an agenda of positive government intervention for creating "participatory" growth.

In general, *IDSRP* attempts to demonstrate the effectiveness of government expenditure and involvement in the provision of services such as education, health care, nutrition, and so on. This contrasts with the view of most observers of the Indian development record, who tend to agree that since its independence from Great Britain in 1947, excessive government intervention in the economy has retarded the country's economic development. It is not at all clear, in this view, that the interventionist Indian state could have done a better job with regard to these social sectors.

The perspective on economic development advocated by Sen and his collaborators can be boiled down to the following arguments:

1. Countries such as China, Taiwan, South Korea, Singapore, and Hong Kong focused on the provision of their citizens' basic needs—the prerequisites of their freedom to achieve their goals in life—either as a precursor to, or simultaneously with, the process of economic liberalization and growth.

2. Within India, states such as Kerala and West Bengal were able to achieve significant progress, outstripping (in the former case) even China and some of the Asian Tigers in terms of indicators of equal basic-needs provision.

3. In each case, government played the crucial role providing essential services to their citizens.

The Failure of Politics in Uttar Pradesh

IDSRP begins with an analysis of the Indian state that has been excoriated by many as a development failure. This is the state of Uttar Pradesh (UP), the largest and most populous jurisdiction in India, and also one of the poorest.

Drèze and Haris Gazdar portray Uttar Pradesh as a case study of retarded development. As a methodological device, they benchmark UP against the region of "South India"—consisting of Andhra Pradesh, Karnataka, Kerala, and Tamil Nadu—as well as against the whole of India.

A dismal picture emerges from Drèze and Gazdar's examination of the aggregate secondary data. UP is found to be severely wanting in terms of every "social" variable in which Sen, Drèze, and their collab-

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orators are interested—infant mortality and survival, child nutrition, fertility decline, basic education, gender inequality, and related aspects of well-being. However, Drèze and Gazdar take great pains to point out that these dismal achievements are not the result of poverty per se, which is no worse in UP than elsewhere in India. "The causes of Uttar Pradesh's extraordinary backwardness in terms of basic social achievements (such as child survival and elementary education)," they write (48), "have to be sought elsewhere." Similarly, they argue that material poverty could not be the cause of UP's social failures because of the significantly different poverty levels experienced by the western and eastern parts of the state, which have similar social indicators.

Drèze and Gazdar pinpoint the primary cause of "social" failure in UP as insufficient government provision of public services. By comparing the levels and growth of government provision of health, education, infrastructure, etc., among UP, South India, and Kerala, they conclude that "Uttar Pradesh stands out as a case of resilient government inertia as far as public provisioning is concerned. Here again, the contrast with Kerala is particularly striking, but even the contrast with South India is quite startling" (53). There is, however, a caveat, since the levels and proportions of government expenditure allotted to health and education in UP and South India are found to be similar. The authors therefore blame UP's social failures on "distorted" patterns of social spending as well as on the "defective" functioning of the services in question.

What started out as an argument for inadequate levels of government involvement therefore becomes an argument for socially harmful behavior on the part of government officials. While the authors invoke caste, class, and gender inequalities; the apathy of the state; tradition; and a lack of social awareness as causes of the lack of social change, in the end they focus on perverse incentives of all levels of government to be corrupt, ineffective, or both.

Drèze and Gazdar's fieldwork in UP is provided as evidence of perverse incentives in the provision of the education, health and infrastructure. In education, for example, they document misdirected school building monies, teacher absenteeism, student absenteeism, lack of accountability by school officials, and even the superior performance of the meager private schooling system. Yet they never consider the implications of the latter point. Instead, they assume that

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the political system can and must be changed through popular agitation if the needs of the disadvantaged are to be met.

The experience of southeast Asian development, however (see Rabushka 1987; James, Naya, and Meier 1989; Lau 1990; World Bank 1993; and Dorn 1998), indicates that it was largely market-oriented economic policy, such as state action enforcing property rights and market institutions, that produced the economic "miracles" in these hitherto poor and backward nations. Meanwhile, a number of studies suggest the intractability of the political problems in places such as UP. Robert Wade (1982, 1984a, 1984b, 1985) has described corruption in the Indian public sector in terms of a "transfer model" that maximizes the (corruption) revenue that can flow from holding a public-sector position while minimizing the number of complaints. This is accomplished by requiring applicants for state employment to buy "transfers." Wade uses official reports and unofficial sources to show the amounts paid to obtain a variety of posts in institutions that provide irrigation, agriculture, and soil conservation at the state- and central-government levels and in public-sector corporations. Salim Rashid (1981) provides a fascinating account of how telephone operators in India arrange for international calls on a priority basis after receiving regular payoffs. N. Vijay Jagannathan (1986) has further detailed the nature of rent-seeking activities in India and other countries. Kreuger 1974 and Kamath 1992 have estimated that the rents generated by various Indian government policies are very large.

If 50 years of democratic politics in India have led to the domination of government by special interests and if state action has been so sorely wanting, one could argue that more reliance on nonpolitical and market forces would have been more likely to help the disadvantaged. This has been the case in the developed Western economies, the Four Tigers, the NICs, and nations such as Chile and Mauritius that have achieved both significant economic development and political and economic freedom.

Drèze and Gazdar, by contrast, blame the failure of public services, and more generally of development interventions, in UP on the state's low commitment to social equity and development, and the failure of civil society to generate a politics that challenges the status quo and more generally promotes the needs of disadvantaged groups. They indict political factionalism based on caste and class as the reason that public action has not been forthcoming in UP, unlike Kerala,

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West Bengal, Karnataka, Maharashtra, Nagaland, and the south Indian states. In UP, the main failures are:

> aborted land reforms, the displacement of health care services by family-planning programmes, the decay of the public schooling system, the wide-spread corruption of poverty alleviation programmes, the suppression of informed women's agency in society, and the fragile basis of local democracy. Underlying these diverse problems is a basic failure of public action—whether of a collaborative or adversarial type—to focus on the promotion of social needs, particularly those of disadvantaged sections of the population. . . . In Uttar Pradesh, extreme inequalities of political power have severely distorted the priorities of state intervention and the implementation of most development programs. The low participation of disadvantaged groups in the political process, in turn, reflects the continuing influence of sharp inequalities relating not only to class but also to caste and gender.

The remainder of *IDSRP* is mainly devoted to showing that the relatively good development record of the Indian states of West Bengal and Kerala can be attributed to class-based politics, leading to concerted state intervention of a sort that, unlike in Uttar Pradesh, produces significant social development.

Democratic Mobilization as a Path to Prosperity

Thus, according to the chapter by Sengupta Sunil and Haris Gazdar on West Bengal, the commitment of successive caste-based left-wing governments since 1977 to improving the position of the rural poor led to a sustained period of agricultural growth and rural transformation between 1983 and 1994. The authors document these claims by using both primary and secondary data. The primary data set is based on World Institute for Development Economics Research (WIDER) socioeconomic surveys of six villages in different agro-climatic zones of West Bengal. The secondary sources are national census and sample survey data, data from the left-wing West Bengal government, data from the private Centre for Monitoring the Indian Economy, and other academic research studies, mostly by left-wing economists.

There is, however, a substantial critical literature that examines the veracity of the claims made by the West Bengal government and by sympathetic academic and other commentators. In order to focus on

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the specific issues considered by Sengupta and Gazdar, I will limit my examination of their claims to the major critiques and to an examination of secondary data, while footnoting other pertinent literature that questions the validity of the claims that they make.[1]

The most comprehensive critique of West Bengal's development policy since 1977 has been provided by Ross Mallick, a Marxist who questions the claims of the Left Front government and sympathetic commentators such as Sengupta and Gazdar. In a series of books and articles, Mallick (1992, 1993, and 1994) has examined the record of the Left Front government in West Bengal and finds its claimed successes to be seriously wanting. Other authors also question these "successes." Let us compare Sengupta and Gazdar's principal claims with the findings of such critics as Mallick.

One of Sengupta and Gazdar's major conclusions is that post-1977 Left Front coalition governments were successfully able to redistribute almost 2.15 million acres of land to landless and land-poor households, so that "nearly 90 percent of the landless . . . received some land" (143). However, the authors' own data show that the number of households that benefitted from land redistribution from 1977 to 1991 only marginally exceeded the number of households that were beneficiaries between 1947 and 1977. They also present data that show that cultivated land redistributed under the Left Front was less than half that distributed by the previous, non-leftist governments. In addition, land distributed per beneficiary was less than half during 1977–91 as during 1947–77.

According to Mallick (1992 and 1993), agrarian reform under the West Bengali Left Front government has been minimal and similar to reforms in other states during the same period. Thus,

> when compared with the other states the Bengal achievement is average at best and often well below the national average, though a communist government would have been expected to surpass all other states in reform implementation. A visit to the most backward district in Maharashtra confirmed this impression. One Maharashtra government official mentioned that while the West Bengal government publicized all their achievements, in his own state they had achieved better results without the fanfare. (Mallick 1993, 10)

Sengupta and Gazdar argue, however, that the redistributive results before 1977 were due to the critical role of the leftist United Front government of 1967–70. But as Mallick points out, the land redistrib-

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ution data used by Sengupta and Gazdar include redistribution figures from the Estates Acquisition Act, which are incorrectly combined with data from the Land Reforms Act. According to Mallick, only the latter can be compared with the land reforms in other states, the former being part of the *zamindari* abolition program adopted nationwide. Mallick (1993) presents comparable data (Table 2.8) that show that West Bengal actually ranked 11th out of 17 states. Even comparing the 17 states on the basis of area distributed as a percentage of cultivable land, West Bengal still ranked seventh, at 0.55 percent, clearly a minuscule amount. Second, Mallick shows that during the 19 months of United Front rule by left-wing parties in 1967 and 1969–70 alluded to by Sengupta and Gazdar, 300,000 of the acres supposedly redistributed were actually lands seized by tenants without waiting for the administration. Even these seizures accounted for a mere 1.8 percent of all cultivable land.

Sengupta and Gazdar also maintain that the Left Front's Operation Barga recorded the tenancy leases of almost 1.44 million sharecroppers. They claim that this has resulted in greater security of tenure as well as higher crop shares going to the tenants (even though the WIDER surveys on this latter score are mixed). The authors admit that based on economic theory and the available evidence, "the efficiency effects" of the Barga system "are not likely to have been unambiguously positive" (155). Nevertheless, they claim that the political impact of the tenancy-rights campaign was extremely significant because it signalled to both supporters and opponents of the Left Front that the government was serious about implementing agrarian reforms.

But Mallick (1993) shows that under Operation Barga, legitimate sharecroppers suffered many injustices while the Left Front's influential sharecropper supporters were rewarded. He points out that less than half the eligible *bargardars* were ever recorded, and that the program was stalled and then ended by Communist politicians in deference to their "elite-base interests" (Mallick 1993, 61). In an exhaustive analysis, he shows that the Left Front government chose not to give priority to the growing class of landless agricultural laborers; that the claimed support for the *bargardars* was grossly overestimated even as their number were in steep decline; that large numbers of *bargardars* were being evicted even as the government claimed success; and that the three-quarters crop share ensured by the operation was shown to be violated in a large number of case studies. He concludes that

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> in short, the landed classes have not disappeared, but what has happened is that elite classes have consolidated their position in the Communist movement and prevented further land reform moves, as interviews with government program administrators confirm. Operation Barga was ended not by a lack of deserving *bargardars*, but because the Left Front's influential sharecropper supporters were already recorded and further work would threaten those supporters already in possession of land. (Ibid., 61)

A major achievement of the Left Front agrarian program, according to Sengupta and Gazdar, is the revitalization of the Pachayati Raj Institutions (PRIs). According to them, the efficacy of these institutions can be gauged by the "success" and the "efficient operation" of the Integrated Rural Development Program (IRDP), a subsidized antipoverty credit scheme that is implemented by the various states on behalf of the Indian government. In addition, they claim that the PRIs have been significant participants in the "successful" implementation of the land reforms and Operation Barga. They suggest that the West Bengal experience with PRIs has been made the model for other states by the Indian government because the success of Left Front candidates in the PRI elections has been overwhelming, with their share of the popular vote consistently remaining around 70 percent.

A number of studies have questioned the Left Front claims that PRIs were successful in achieving radical agricultural and economic transformation in West Bengal, especially with regard to the IRDP program. Mallick (1993), in particular, documents how the PRIs became the predominant source of political patronage in rural areas under successive Left Front governments, and how the priorities of the Panchayats were often misconceived or aimed at benefiting the richer sections. His data on the educational and economic characteristics of PRI members show that they were predominantly from well-educated and land-holding backgrounds, contradicting the Left Front government's claims that the majority were impoverished villagers.

Mallick (1993, 145–49) also cites extensive evidence to show that the West Bengal administration of IRDP was unexceptional. A World-Bank commissioned study, for example, severely criticized the implementation of IRDP in the state and noted that, for a number of reasons, there was "poor performance of the state in IRDP" (Institute for Financial Management and Research 1984). The study compared

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the implementation of the IRDP in four states, including West Bengal, and concluded that in West Bengal the achievement rate was the lowest. Other Indian-government commissioned studies reached similar findings.

Sengupta and Gazdar contend that the election of the Left Front broke the trend of stagnation in agricultural growth between 1969 and 1982. However, the authors concede that the "agricultural take-off" during 1983–94 was similar to that experienced by other states (such as Bihar and Orissa) that did not have leftist governments and "radical" agrarian programs. Therefore they can only arrive at the underwhelming conclusion that "the recent growth record of West Bengal dispels any possible apprehensions that redistributive reforms might have had *negative* effects on efficiency" (169).

Other observers agree. Hanumantha Rao (1993) presents data that show that while West Bengal's 4.53 percent annual increase in grain output from 1977–78 to 1988–89 was much higher than the 2.6 percent growth rate from 1967–68 to 1977–78, the higher rate was matched or exceeded by other Indian states with none of the institutional changes that were introduced in West Bengal. Grain output grew by 5.16 percent annually in Uttar Pradesh from 1977–78 to 1988–89, by 4.57 percent in Punjab, and by 4.36 percent in Madhya Pradesh. Comparing triennial average grain production over three periods, Utsa Patnaik (1993) shows that the share of the Eastern region, including West Bengal, actually declined in the 1980s compared to the Northern and West-Central regions.

Sengupta and Gazdar also claim that there was a significant decline in the West Bengali Head-Count Ratio (HCR), which measures the proportion of the population with incomes (or expenditures) below the poverty line. After examining NSS data compiled by Suresh Tendulkar, K. Sundaram and L. R. Jain (1993), they conclude that even though West Bengal had the highest HCR of all Indian states when the Left Front government came to office in 1977, it experienced the highest proportional rate of decline of all the major states between 1983 and 1987, enabling it to leave the two other poorest states, Bihar and Orissa, behind. However, their analysis of consumption studies shows that there was only "marginal improvement" in overall consumption levels, though they contend that there might have been some significant distributional improvement.

Mallick's and others' criticisms of the Left Front governments' poverty-alleviation and redistribution programs brings into serious

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question the success alleged in these areas. They show that Left Front efforts to desegregate untouchables, improve literacy, reform education, improve employment, redistribute consumption, reduce poverty, and reform public health and taxation were either unsuccessful or woefully inadequate. According to Mallick (1992, 738):

> In fact, neither the West Bengal health or literacy programs have been particularly impressive when compared with other states. Though both programs have provided rural employment for party supporters, standards have often been poor. An interstate comparison of health expenditure indicates West Bengal is not exceptional in its outlay. . . . As for education, enrollment under the Left Front increased at the same rate as under the previous Congress government, although as one of nine "educationally backward" states it has a lot of catching up to do. With little growth in Untouchable and Tribal enrollment, however, the gap between the education of lower and higher castes has widened.

According to another commentator, Myron Weiner (1991, 186), "the Communist government of West Bengal is no more committed to the enforcement of child-labor laws or compulsory-education laws than the Congress-dominated conservative state of Bihar next door." According to the Government of India's Ministry of Education and Culture, West Bengal was one of the nine states "educationally backward in elementary education which together comprise[d] three quarters of the non-enrolled children" in India (Planning Commission of India 1985, 92). Similarly, Mallick (1993) shows that the Left Front government has been deficient in the provision of nonformal and adult education. Indeed, he shows that, under the Left Front, expenditure on secondary education has exceeded primary-level education.

Mallick (1993, 57) and others, such as Bruno Jobert (1985, 15) have shown that the Left Front government in West Bengal has not made health financing a priority when health expenditure is compared with the national average; and, in fact, that, just as in education, these programs have been used predominantly for distributing political patronage. Similarly, with regard to agricultural taxation, Mallick (1993, 103–16) shows that the West Bengal state government was unwilling and unable to implement a progressive taxation system, due to the influence of its landed agricultural interest base.

Mallick (1993, 61–79) also shows that the Left Front government's program for rural credit and input provision, which it touted as an

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important component of its agrarian reforms, was quite arguably the least successful of its agrarian reform programs. He shows empirically that the Left Front's minimum-wage and other policies were statistically no different than those of other non-Communist regimes. In fact, he argues that the performance of the Left Front governments was worse than that under previous Congress regimes.

Mallick's criticisms are backed by a substantial body of evidence, as reflected in the work of Ashok Rudra (1985), Roy Chaudhury (1985), Bikram Sarkar (1989), and Avrild Ruud (1994). Ruud, for example, using primary data from the Communist stronghold of Burdwan, shows that the United Front's achievements in all the areas discussed above were limited, if not nonexistent, and that the Communists and their Left Front partners were able to obtain the moral and electoral support of voters in this district because of political patronage similar to that of previous noncommunist regimes.

What about Sengupta and Gazdar's claim that there was a substantial improvement in the distribution of consumption, in that the consumption of the poor rose proportionately more than that of the nonpoor after 1977? They base this conclusion on the increase in the daily wage rates of male agricultural laborers in the six villages that WIDER surveyed. In addition, they claim that in West Bengal the growth of wages outstripped the growth in output compared to the neighboring states of Bihar and Orissa, leading to a significant improvement in the distribution of consumption in West Bengal relative to the other states. Yet the authors themselves note that this uptick was hardly unique: after 1977, neighboring states—and the rest of India—experienced similar improvement.

However, Mallick (1993, 92 and 116–23) shows that due to the failure of the Left Front government's employment, wage, and food-pricing policies, the consumption of the poorest sections of society could not have been improved. He argues that the Communists' demand for higher procurement prices for agricultural output during these years should be seen as an attempt to gain patronage with the landlords and rich and middle-income peasants who controlled the land.

Similarly, a substantial body of evidence shows that the public-choice incentives facing the Left Front governments of West Bengal were no different from those that corrupted earlier noncommunist regimes. Robert Wade (1982, 1984a, 1984b, and 1985) has extensively documented the payoffs and patronage that permeate governmental

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administration in India, mainly in the southern states but also in West Bengal, due to these incentives. And N. Vijay Jagannathan (1986 and 1987) documents the nature of corruption and delivery systems in West Bengal and other Indian states under various regimes, including the communists.

Sengupta and Gazdar (198) verge on recognizing the tendency of the Left Front toward not only corruption but demagoguery when they explain why West Bengal's performance on key socioeconomic indicators, such as infant-mortality reduction and improvement in child nutrition and literacy, are not very impressive—worse, in fact, than in a number of other Indian states:

> The overriding concern with the agrarian-reform agenda, however, has also been, at least partially, responsible for the almost complete neglect of claims which might arise from other sources of social and economic equity. . . . Indeed, the near exclusive concern of the Left Front organizations with agrarian politics, and the establishment and redistribution of property rights in land, is an important factor in their neglect of individual rights to a minimal level of education and health care. (198)

This assessment is consistent with the following summary of the evidence regarding the failure of radical democratic politics in West Bengal. First of all, the Left Front government succumbed to interest-group politics and political-patronage incentives—as well as the need to mobilize support through high-minded but unfounded claims of redistributive success—that were no different from those demonstrated by other non-communist governments in West Bengal and other Indian states. This is to be expected in an economy dominated by extensive government regulation and intervention and limited recourse to markets. And second, given the entrenchment of the caste system and other social institutions such as untouchability, the controls and dependence on administrative fiat and regulations perversely strengthened the privileges of politicians, bureaucrats, and the wealthy, and created even greater scope for rent seeking and patronage.[2]

Sengupta and Gazdar admit many caveats to their claims, the net effect of which (along with the claims contradicted by other evidence) is to render the West Bengal experience with "radical grassroots" change more illusion than reality, failing to provide much sup-

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port for Sen and Drèze's hypothesis that broad-based "participatory development" is conducive to individual well-being.

A Requiem for the "Kerala Model"

V. K. Ramachandran's essay in *IDSRP* examines the "Kerala Model" of development, which, he contends, "shows that the well-being of the people can be improved, and social, political and cultural conditions transformed, even at low levels of income, when there is appropriate public action" (207). Ramachandran attempts to demonstrate that Kerala's substantial improvements in life expectancy, infant mortality, literacy, education, public health, women's "agency," and living standards in general have been due to concerted public action by nineteenth- and twentieth-century governments in Kerala, especially by the Communist-led governments since the 1950s. Kerala, then, is presented as another case study in the efficacy of participatory democratic politics in achieving well-being for the poor.

Ramachandran first chronicles the dismal performance (absolutely and relatively) of Kerala in the post-independence period with regard to production, productivity, employment, agriculture, proportion of population below the poverty line (i.e., the head-count ratio), capital investment, net value-added, entrepreneurship, and other "conventional" indicators of economic performance. In suggesting that future advancement in these areas can be achieved only by "public intervention . . . of governments and intervention by political parties and mass organizations" (224), he neglects the possibility that such intervention—which he takes to be the source of Kerala's substantial gains in less conventional measures of well-being—might be responsible for the state's utter failure to alleviate poverty as conventionally understood. It is as if a contemporary economist argued that the alleged achievements of the Soviet Union in literacy, education, public health, and so forth were the results of government intervention, while the USSR's dismal economic performance was due to some extraneous cause—not the very same intervention.

But is it even true that responsibility for Kerala's famous achievements in nutrition, literacy and education, public distribution, women's agency, and agricultural and land reform are due to left-wing political participation?[3]

Ramachandran acknowledges the achievements of private efforts

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and pre-independence governments in these areas, but insists that these improvements must be mainly attributed to the efforts of the communists and their governments:

> Kerala is one part of India where the Communist party assimilated the most progressive features of diverse socio-political movements and gave them a new philosophical and political direction. . . . Communists were among the early organizers of mass political organization of women in the state. Communists played a leading part in the literacy movement and in the cultural movement (including the theater movement) in Kerala. Schoolteachers were key activists and mass organizers of the national movement and the Communist party; they were the first organizers of the *granthashala* (library) movement and the movement for literacy in Malabar. In the nineteen-seventies and eighties, Communists were the main activists . . . in the Total Literacy Campaign. . . . The first government of (post-independence) Kerala was a Communist government, and the major features of its agenda and of later communist ministries in the state were, among other things, land reform, health, education, and strengthening the system of public distribution of food and other essential commodities. (314–15)

Ramachandran identifies government policy as playing a key role in land reform, health, education, public distribution, and demographic change. He concludes that "in the conditions of contemporary India, it is worth remembering that public action, and not policies of globalization and liberalization, was the locomotive of Kerala's progress" (328).

Let us examine Ramachandran's claims with regard to literacy and education first. Ramachandran treats the work of Robin Jeffrey (1976 and 1992) as supporting the primacy of state activism in the development of literacy and education in Kerala. However, a careful reading of Jeffrey's work provides a very different picture from that painted by Ramachandran. Jeffrey (1976) shows that there was a substantial system of indigenous schools before schools were established by government policy. While he (like Ramachandran) contests Kathleen Gough's (1968) estimate that as many as 50 percent of men and 25 percent of women were literate during the late nineteenth century, he does point out that there are good reasons for presuming that literacy was more widespread in Kerala than anywhere else in India.

Jeffrey (1992) points out that from the first censuses of the 1890s, Cochin, Travancore, and Malabar (the three constituent areas of mod-

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ern Kerala) showed higher literacy rates than India as a whole. He also demonstrates that by 1911, Travancore and Cochin were the most literate areas in India—three times more literate than all of India, with laggard Malabar twice as literate as the rest of the country. "The remarkably high early rates of literacy," according to Jeffrey (1992, 56), "resulted from the complex interaction of old Kerala's culture with an expanding cash economy and princely governments intent on 'improvement.'"

Contrary to Ramachandran's interpretation, Jeffrey (1987, 1992) argues that Kerala's culture—particularly its attitudes toward women, and women's attitudes about themselves—explain Keralites' eagerness to become literate. He argues that governments and their policies affected at most the timing at which particular groups became literate. Indeed, he shows that government involvement and regulation often caused literacy to drop, as in the case of Cochin between 1891 and 1901. During this period, government abruptly intervened in the largely private school system, leading to a drop in enrollment of the majority "respectable poor" but an increase in the enrollment of the minority children of affluent families. He goes on to document the role of private education in promoting literacy in Kerala even in the modern period.

> The way in which education spread rallied people around organisations and propagated attitudes about demands and competition. Private management, receiving government grants, conducted most schools, and by far the largest categories of recipients were the various Christian sects. By the 1950s, however, the Nair Service Society and other private managements were also large and powerful. Education was thus inextricably linked with 'ethnic politics', both in the organisation it fostered and the way in which reading, writing and school-going formalised perceptions about the identities of groups. (Jeffrey 1992, 55)

Terrence Nossiter (1982, 33) notes that even in 1978–79, the private sector managed 59 percent of lower primary schools, 68 percent of upper primary schools, and 65 percent of high schools, with more than half the school children in the state attending either government-aided private schools or private independent schools.[4] These schools are run by the Nair Service Society, the Muslim Educational Society, the Catholic Church, various Protestant organizations, and private businessmen.

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Jeffrey (1987, 469) concludes that

> The example of literacy in Kerala also suggests the need to modify the emphasis sometimes placed on governments and institutions in explaining social and political events in modern India. The notion that governments initiate and people respond—often, to be sure, in unpredictable ways—is too tidy and simple. The acceleration of literacy in Kerala resulted first from the exploitation of existing cultural strengths: the relative freedom of women and the popular, old style schools. Malayalis were culturally attuned to schooling of a particular, local kind in which girls participated. . . . Governments, to be sure, influenced their subjects, but rarely, I suspect, directed them down paths they were not already inclined to go.

Similarly, Ramachandran's arguments about women's agency in the post-independence period need to be tempered by Jeffrey's work (1976, 1987, 1992). It shows that the roots of women's substantial advancement, compared to other Indian states, lay in the matrilineal system of Nayar society, which generated attitudes that were transferred to other caste groups in Kerala society. The breakup of the matrilineal system by legislation did not diminish the special roles and freedoms accorded to women in Kerala. Jeffrey also traces the emphasis on education and health to the critical role of women in Kerala.

In concluding his rather comprehensive and well-argued book, *Politics, Women, and Well-Being*, Jeffrey (1992, 217) makes the following startling claim contra Ramachandran:

> There is no Kerala model—neither in the sense of coherent policies that have produced specific results, nor a desirable goal that other parts of India or the world might wish to achieve. The remarkable social statistics that have intrigued scholars since the 1970s stem from the way in which public politics and the role of women took shape between the 1920s and 1950s amid the dissolution of old Kerala. The outcome in the 1990s is a society in which most people have skills (notably literacy) and some resources (perhaps a patch of ground) to prolong life and bandage the jagged edges of poverty.

Meanwhile, the experience of Kerala regarding land reform has been very similar to that of West Bengal detailed above. Ronald Herring (1983), Mallick (1993), and particularly Brian Morrison (1997) all conclude that the land reform program in Kerala has failed in achieving its stated objectives. According to them, the half-measures that

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have been implemented as part of the land reforms have resulted in the *embourgeoisement* of the Kerala farmer, with a consequent accentuation of wealth and income disparities and greater opposition to more substantial reforms. This has had the consequence of maintaining the status quo in favor of the rich.

Thus, the real (as well as the merely apparent) advantages of Kerala in terms of non-economic measures of well-being cannot be attributed to democratic politics and state action; but it is plausible, at least hypothetically, that on the contrary, politicization and interventionism do explain the poor economic performance of Kerala. As Jeffrey (1992, 222) puts it, "Keralans regard the risks in their own state as too great: knowledge of the possibilities for dispute and loss make it more attractive to work and invest elsewhere."

Women's Agency and Socioeconomic Development

In an earlier volume, Drèze and Sen (1996) prefigure the chapter in *IDSRP* arguing that gender equality and women's "agency" is critical for socioeconomic development. Both pieces attempt to show that extraordinary levels of female deprivation and gender inequality are among India's most serious social development failures; that gender inequality and female deprivation do not automatically decline with economic development; that even when economic growth has a positive influence on the status of women, its influence is slow and indirect; that gender inequality is not only a social failure in itself, but also can lead to other kinds of social failure, such as illiteracy, greater child mortality, and in fertility; and that the relationship between gender inequality and economic development may be nonlinear, with the relative position of women first declining and then improving as the level of per-capita income or some other suitable economic indicator increases.

Using cross-sectional data based on India's 1981 census, *IDSRP* establishes that rates of female literacy and labor-force participation (variables that directly relate to female agency) have a strong and statistically significant negative effect on female disadvantage. While there are significant methodological and statistical problems (as discussed by the authors) with such a regression analysis-based approach, nevertheless the overall causal linkage is broadly plausible and is supported by other studies.

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Accepting the validity of the empirical evidence, however, all that can be claimed is that female labor-force participation and female literacy have a positive relationship with the reduction of female disadvantage. The evidence and the development experience of the rest of the world cannot support the inference that such disadvantage has been reduced only by rapid and radical social change through public action.

Clearly, as the example of Kerala shows, women's agency can be facilitated by cultural factors rather than by concerted public action or political agitation. The development of women's agency in the developed world can hardly be claimed to have been the result solely of concerted public action or political agitation. Many countries that have resorted to such means (for example, the Soviet Union and Communist China) did not demonstrate the improvements in social agency claimed by their advocates (see Eberstadt 1990). In addition, as Drèze and Sen themselves point out (366), economic development can itself lead to a reduction in gender bias through the expansion of female literacy. And with economic development and increased economic opportunity, female labor-force participation can lead to reduced gender bias.

* * *

Amartya Sen is one of the most important political philosophers of our time. I have not even touched on his vast and influential work in this area. However, his theses about the sources of economic development in the Third World may be even more influential. And, on the basis of *IDSRP*, one has to conclude that these theses are questionable, at the very least.

NOTES

1. Other prominent critiques of the Left Front government's development record may be found in Rudra 1977 and 1985; Roy Choudhury 1980, 1985; Sarkar 1989; and Ruud 1994. Studies endorsing the development reforms and record of the Left Front Government include Kohli 1987, Rudolph and Rudolph 1987, and Nossiter 1988.
2. While certainly not the interpretation drawn by Marxists such as Mallick and Rudra, this conclusion is supported by the evidence that they and others present and is explicitly pointed out by Shenoy 1971; Krueger 1974; Rashid 1981; Mohammed and Whalley 1984; Roy 1984; Wade 1984a, 1984b, and 1985; Jagannathan 1986 and 1987; and Kamath 1992 and 1995.

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3. Even here, Ramachandran dismisses the higher prevalence of disease and morbidity and the lower caloric intake and lower food consumption of Keralites extensively documented in the development literature on the basis of alleged shortcomings of the data.
4. Drèze and Sen's contention that literacy and mass education are primarily the result of the activities of the modern state are also brought into question by West 1970 and 1975, in the case of England, and Seybolt 1969 and 1971; Kaestle 1973 and 1978; High 1985; and High and Ellig 1988, in the case of America.

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Wolfgang Kerber and Sandra Hartig

THE RISE AND FALL OF THE GERMAN MIRACLE

ABSTRACT: *The fast recovery of Germany's economy after World War II—the so-called "German miracle"—can be explained by the market-oriented economic policies pursued in the 1950s, based upon the ideas of Ordoliberalism. The slowing growth rates and increasing economic difficulties since the 1970s seem to have resulted from the extension of interventionist and redistributionist policies beyond those sanctioned by Ordoliberalism. The roots of the German economic decline are political: already in the 1950s, a broad consensus existed about the need to integrate market-oriented economic policy with a highly redistributory welfare state in a "social market economy."*

After the catastrophe of National Socialism and World War II, West Germany's economy recovered surprisingly quickly in the 1950s—the period of the "German miracle." But although Germany still has the strongest economy in Europe, it is widely acknowledged that today the German economy suffers from considerable structural problems, manifesting themselves in slow growth, high unemployment, a huge government debt, and severe financial crises in the social security system (e.g., Sachverständigenrat 1999, 43–117). Several years ago, in *The Fading Miracle: Four Decades of Market Economy in Germany*, Herbert Giersch, Karl-Heinz Paqué, and Holger Schmieding suggested that the German miracle was due to sound market-oriented economic

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policies, which allowed for the working of the spontaneity of markets, whereas its fading can be traced back to the post-1950s growth of regulation and corporatism. In this essay we want to discuss this proposition in the light of more recent developments. To this end we will discuss the characteristics specific to German capitalism, both in the successful period of the 1950s and 1960s on one side, and in the more difficult years since the mid-70s on the other. This will require us to analyze two overarching German ideas about the role of the state in market economies: the doctrine of "Ordoliberalism," and the notion of a "Social Market Economy."

West Germany's "Economic Miracle"

After the end of the national socialist dictatorship, industrial production in West Germany recovered slowly, in 1947 reaching only 33 percent of the 1938 level (Statistisches Bundesamt 1956, 141). The main problem was not a lack of capital—the capital stock of 1945 surpassed that of 1936 by 20 percent (Hardach 1993, 45)—but the restrictive institutional framework for economic transactions which was the heritage of the centrally administered Nazi economy. This included both the rationing of many consumer goods, raw materials, and energy and investment goods; and the fixing of prices, wages, and rents. The level at which prices were frozen reflected the burst in the money supply that had paid for both the massive German rearmament in the second half of the 1930s and for the war. The huge expansion of the money supply had, as early as 1936, made price controls necessary to prevent inflation (Giersch, Paqué, and Schmieding 1992, 19). Due to this "repressed inflation," the postwar Reichsmark became worthless, leading to the dominance of barter transactions among privately owned firms (Buchheim 1991, 60).

Both the three Western Allies and the Germans knew that reforms were inevitable. One year before the founding of the Federal Republic of Germany in 1949, Ludwig Erhard, as the director of the (U.S. and British) Bizonal Economic Administration, got the consent of the majority of the Bizonal parliament to carry out his radical plans for the reinstitution of a market economy (Giersch, Paqué, and Schmieding 1992, 32ff.). In June 1948 a currency reform was enacted by the Western Allies, and important steps were taken for the liberalization of markets. A new Deutschmark replaced the Reichsmark,

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and immediately a money economy replaced bartering (ibid., 36ff.; Buchheim 1998). This also marked the beginning of the modern German tradition of an independent central bank. The independence of the central bank from the rest of the government was deemed an institutional safeguard against the recurrence of such disasters as the post-World War I hyperinflation and the pre-1948 repressed inflation.

The currency reform was directly accompanied by Erhard's decision to abolish the system of central planning in the Bizone by lifting price controls on almost all manufactured goods and some foodstuffs, and by rescinding rationing and the central allocation of resources (Giersch, Paqué, and Schmieding 1992, 37ff.). Although basic foodstuffs, most raw materials, wages, and rents were exempted from this liberalization for the moment, Erhard's 1948 guidelines on economic decontrol enunciated a clear commitment to a market economy and the beginning of a broad program of liberalization; and in the following years, the conservative government of Chancellor Adenauer turned the German economy step by step into a free market (ibid.; Ambrosius 1977, 171ff.). At the same time, reforms in the tax system reduced tax rates and favored the accumulation of capital through tax exemptions (Giersch, Paqué, and Schmieding 1992, 38). Finally, a law against restraints on trade ended a tradition of cartelization that went back to the legal approval of cartels that had begun in 1897 (Kartte 1969, 15–23).

As yet, however, Germany was not integrated into the international economy. The Deutschmark was not convertible, and trade with the rest of Europe was coordinated by bilateral agreements. Although the Marshall Plan was intended to spur multilateralization (Hardach 1994), its effect was more that of political stabilization than of economic recovery (Giersch, Paqué, and Schmieding 1992, 97ff.).

The strenuous transition to currency convertibility, which lasted until 1958, was facilitated by the founding of the European Payments Union (EPU) as a multilateral clearing system in 1950. In the 1950s, Germany was transformed from being an extreme debtor to a creditor nation (Kaplan and Schleiminger 1989). Due to the U.S. insistence on a general liberalization of international trade, which led to the creation of GATT and the OEEC (later OECD), Germany became a pacemaker of the European trade-liberalization movement. By 1958, 94 percent of private German imports from OEEC countries (representing 82.6 percent of all German imports) were free of quantitative restrictions (Giersch, Paqué, and Schmieding 1992,

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Figure 1: German Unemployment, 1950–1998

Year	West Germany	Germany
1950	11.0	
1952	9.5	
1954	7.6	
1956	4.4	
1958	3.7	
1960	1.3	
1962	0.7	
1964	0.8	
1966	0.7	
1968	1.5	
1970	0.7	
1972	1.1	
1974	2.6	
1976	4.6	
1978	4.3	
1980	3.8	
1982	7.5	
1984	9.1	
1986	9.0	
1988	8.7	
1990	7.2	7.2
1992	6.6	8.5
1994	9.2	10.6
1996	10.1	11.5
1998	10.5	12.3

Source: BMA 1977, 2.10; 1998, 2.10.

109). Parallel to its external liberalization, the German economy became increasingly export-oriented (ibid., 13ff.).

During the 1950s, annual German real GNP rose by an average of 8.2 percent, and there was a continuous decline in unemployment from 10 percent to 1 percent (Giersch, Paqué, and Schmieding 1992, 2ff.; see Figure 1). This is particularly remarkable given that the German labor market had to absorb 9,000,000 refugees from the former German territories (Bethlehem 1982). After some volatility directly

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after the currency reform, increases in the consumer price level remained below 4 percent until the end of the 1960s (Giersch, Paqué and Schmieding 1992, 12). In short, the economic benefits of the establishment of a market economy were tremendous. Real wages rose an average of 6 percent in the 1950s (ibid., 71ff.), the general standard of living increased enormously, and unemployment was virtually eliminated.

Ordoliberalism and the Social Market Economy

Giersch, Paqué, and Schmieding (1992, 68ff.) characterize the development of West Germany's economy of the 1950s as the outcome of a "supply-side miracle."[1] But what were the economic ideas behind the German market-oriented policy after the war? Erhard's 1948 reforms were based upon "Ordoliberalism," the doctrine of the Freiburg School of Law and Economics. In the aftermath of the global economic crisis after 1929, trust in the workings of market economies was shattered throughout the world. In Germany, where ideas of economic liberalism had never been very popular, Hitler encountered no resistance in transforming Germany's already cartelized economy into an even more centrally administered economy geared to producing armaments and waging war, leading economically both to the elimination of unemployment and the emergence of inflationary pressures (Giersch, Paqué, and Schmieding 1992, 19–22). The Ordoliberals, who were in clear opposition to National Socialism, were a group of economists and legal scholars, many of whom had been forced to leave Germany in the 1930s, but some of whom were still teaching at German universities; foremost among the latter group was the economist Walter Eucken in Freiburg. Since the late 30s they had attempted to develop an innovative conception of the market economy that became the intellectual basis of the economic recovery after Germany had lost the war.[2]

Rejecting Marxist central planning (and therefore implicitly also the Nazi variant of central planning), corporatism and its tradition of cartels, and interventionism (the predominant form of economic policy in the 1920s, which had led to massive rent-seeking behavior by interest groups), the Ordoliberals advocated a genuine market economy (Eucken 1952). But they also rejected minimal statism; in their opinion a laissez-faire economy would fail to ensure the proper

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working of markets, due to an inherent tendency for the cartelization and monopolization of markets (Eucken 1952, 30ff.). Normatively the Ordoliberals wanted to realize individual freedom and solve the problem of scarcity (in modern terms: efficient allocation). Unlike classical liberals, they were convinced that achieving these goals required restricting not only the power of governments, but also that of private agents, especially firms and large interest groups (ibid. 169–79). Therefore the Ordoliberals demanded legal protections of competition against restraints on trade, as well as a central bank, but one insulated from politics as an institutional safeguard against inflation (Bernholz 1989).

But the most important general idea of the Ordoliberals was that both the smooth working of the price system and the protection of individual freedom against the power of the state and of private agents can be achieved best by establishing an institutional framework (a set of general rules) for the markets, within which economic processes should take place with as little government intervention as possible. Therefore economic policy should take the form of appropriate general rules for the proper working of markets. Discretionary, interventionist economic policy should be avoided as far as possible (Eucken 1952, 334–38). Ordoliberals advocated a "strong" state to establish a set of general rules but they rejected discretionary regulations, which hamper the proper working of markets. It was especially important to them that economic policies should not interfere with the smooth working of the price system (Röpke 1942, 252–58).

Ordoliberalism is no "third way" between capitalism and socialism; it should be seen as a specific form of liberalism. The difference from laissez-faire liberalism lies in its insistence that markets can fulfill their positive functions only if the state establishes a clear institutional framework within which spontaneous market processes take place. In that respect the Ordoliberal approach has many parallels to F. A. Hayek's emphasis on the importance of general rules (the "rule of law") for the emergence of spontaneous order (Hayek 1960). But in contrast to the Ordoliberals, Hayek was much more skeptical about the capability of the human mind to design the required set of rules for this institutional framework. Given the experience of Germany in the 1930s, the Ordoliberals had little confidence in the spontaneous emergence of appropriate institutions, such as that displayed by Hayek in his theory of cultural evolution (Hayek 1973).

Ordoliberalism is one of the early precursors of modern institu-

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tional economics, especially the "property rights approach," "law and economics," and in particular "constitutional economics" (Buchanan 1987)—which, in separating the "choice of rules" from "choice within rules," can be seen as very close to the Ordoliberal idea that after setting down an institutional framework of rules of the game, the state should refrain as much as possible from intervening in the game (Vanberg 1988; Leipold 1990).

The Ordoliberal view gave Ludwig Erhard clear theoretical guidelines for his step-by-step policy of transforming the centrally administered economic system of Germany into a genuine market economy during the 1950s. Although socialist ideas of different kinds were popular after the war in West Germany, the rapid success of Erhard's reforms in reducing unemployment and increasing standards of living for wide parts of the population led to an increasing acceptance of the market economy. This development was supported by the coinage of the term *social market economy* for this specifically German form of capitalism. The basic idea of the "social market economy" (Müller-Armack 1956; Giersch, Paqué, and Schmieding 1992, 31ff.) was the claim to integrate the concept of the market economy with the welfare state. The Ordoliberals were, in fact, very reluctant about welfare statism, arguing that the best social policy would be not political redistribution, but market productivity leading to higher wealth for everyone (Eucken 1952). But "social security" as a central task of the state enjoyed great resonance in Germany, dating from Bismarck's introduction of a state-based social security system in the 1880s, so the idea of combining a market economy with the welfare state had great appeal—even leading the Social Democratic Party in 1958 and the trade unions in 1963 to accept the concept of the social market economy (Giersch, Paqué, and Schmieding 1992, 155).

The result of this development was a double one. On one side, already in the 50s a relatively clear decision was achieved in West Germany in favor of a market economy and against socialism, bolstered by the negative experiences of East German socialism. But since German economists never really succeeded in developing a consistent concept of a "social market economy," in which redistributive social policy could be reconciled with a market economy, this broadly accepted concept was characterized by a broad vagueness, deep tensions, and clear contradictions (see, e.g., the critical appraisal in Wiseman 1989) between the aim of a genuine market economy, as

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advocated by the Ordoliberals, and the strong German tradition of a welfare state with redistributory intentions and corporatist elements.

Inflation, Unemployment, and the Failure of Keynesian Macroeconomics

In the 1960s, Germany saw both a continuation of the "economic miracle" of the 1950s and a transition to the growing economic difficulties that became apparent in the 70s. The average real growth rate was still 4.4 percent annually and the labor market was characterized by a chronic shortage of labor (Giersch, Paqué, and Schmieding 1992, 11), producing an average rate of unemployment until 1973 of around 1 percent (BMA 1998, 2.10) despite a strong influx of foreign labor. Unemployment was so low because wage increases lagged behind productivity gains, and an undervalued currency led to soaring exports (Giersch, Paqué, and Schmieding 1992, 126ff.).

But this situation also raised the rate of inflation, which had remained between 1 and 4 percent in the 1960s but rose to 7 percent in 1973–74. Given the Bretton Woods fixed-currency system, Germany's export boom implied high currency surpluses in the 1960s (Holtfrerich 1998, 407ff.), and the Deutsche Bundesbank increasingly had to face the problem that the influx of capital expanded the domestic money supply, importing inflation. Since the revaluations of the Deutschmark in 1961 and 1969 were not sufficient to overcome the undervaluing of the German currency, repeated speculative attacks led to the decision by Germany and other countries in 1973 to switch to floating exchange rates. This breakdown of the fixed currency system made it possible for the Deutsche Bundesbank to control the domestic money supply and allowed it to pursue a restrictive monetary policy so as to regain price-level stability (Giersch, Paqué, and Schmieding, 1992, 176–84). (By the beginning of the 1980s, the Deutsche Bundesbank, supported by a great fear of inflation in the German population, won its reputation for pursuing monetary stability, safeguarded by its political independence.)

This transition period up to 1973 was also characterized by the spread of Keynesian macroeconomic demand management, which had been popular in the United States since the beginning of the 1960s. At the same time, the conservative coalition government of the Christian Democrats and the liberal Free Democrats was replaced by

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a coalition of the Christian Democrats and the Social Democratic Party (SPD) in 1966, and finally by a coalition government of the SPD and the Free Democrats in 1969, under chancellors Willy Brandt (1969–1974) and Helmut Schmidt (1974–1982). After an independent Council of Economic Experts was established in 1963 and a Law for the Promotion of Economic Stability and Growth was enacted in 1967, the deficit spending policies necessary for pursuing Keynesian aggregate demand management became conceivable in the pursuit of price stability, full employment, foreign-trade balance and adequate economic growth (Giersch, Paqué, and Schmieding 1992, 148). Together with a general change of the political climate in Germany, leading to a more critical attitude to the market economy and a greater emphasis on "social justice," it was thought that the government should exert a much more active role in steering and controlling the German economy than under the previously dominating Ordoliberal concept of the market economy. In addition to discretionary anticyclical Keynesian aggregate demand management to fine-tune business cycles (Scherf 1986), there was a general tendency to extend regulations in many fields, especially in the labor market, so as to protect consumers and workers and to expand the redistributive German welfare state. But the limited success of such policies soon became apparent.

After 1973, the state of Germany's economy worsened for several reasons. One problem was that the economic boom at the end of the 60s and the beginning of the 70s, prolonged by inflation that could not be fought before the transition to floating exchange rates, had led to a distorted and hence unsustainable structure of production (Giersch, Paqué, and Schmieding 1992, 133ff.). Presumably more important was the increasing cost of labor. In the 60s, trade unions were moderate in their demands for higher wages, and there was no rise in real unit labor costs. The situation changed dramatically in 1969–70, when the trade unions—spurred by wildcat strikes and the expectation of rising inflation rates—switched to a more aggressive posture (Giersch, Paqué, and Schmieding 1992, 156ff.). Salaries in the public sector rose by 11–12 percent in 1974, and other industries followed with wage increases above 10 percent (Scherf 1986, 37). Furthermore, the unions also used wage negotiations as a means for redistribution, especially in the lower wage classes. As a consequence of wage increases that exceeded productivity increases and inflation rates, the real unit labor cost increased by 1.6 percent annually between 1969

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and 1974 and at a slightly lower rate in the second half of the 1970s (Giersch, Paqué, and Schmieding 1992, 132, 198). This encouraged the substitution of capital goods for labor. The first and second oil crises in 1973 and 1979 brought about an additional rise in production costs through enormous price increases for raw materials, especially crude oil. Counteracting this worsening in the terms of trade would have required sacrifices in real wages to avoid rising unemployment, but these did not take place.

As a consequence the German economy suffered deep recessions 1975 and 1982, in which unemployment rose from 1.3 percent in 1974 to 7.5 percent in 1983 (BMA 1998, 2.10). Since then, as can be seen in Figure 1, German unemployment rates have increased sharply in recessions, but have declined only to a small extent in the boom periods, leading over several business cycles to a terraced pattern of mounting unemployment that can be observed until today. Correspondingly, the average growth rate fell to 2.2 percent between 1973 and 1980 (Giersch, Paqué, and Schmieding 1992, 4). The German government attempted to fight the economic crises by applying the newly introduced macroeconomic instruments, but Keynesian investment programs financed by budget deficits, due to political and economic time lags, were partly procyclical, and rising public spending could not be reduced enough in the boom phases of the business cycles (Scherf 1986). This led to the additional problem of major budget deficits, which have persisted in Germany up to the present.

The Crisis of the Welfare State

Eventually it came to be thought that many of the problems of the German economy, especially the high rate of unemployment, were not susceptible to macroeconomic solutions. Since a high proportion of unemployment in the 1980s and 1990s seemed to have not cyclical but structural causes (Giersch, Paqué, and Schmieding 1992, 201ff.), it was suggested that economic policy should focus on solving problems on the micro level, implying a turn to so-called neoliberal or supply-side policy. This development can be seen as reflecting the influence on German thinking of Thatcherite and Reaganite reforms, but it can also be interpreted as a renaissance of the old Ordoliberal market-oriented concepts of the 1950s.

The basic insight was that the economic problems of late twentieth-

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century Germany were a consequence of failing incentives on the supply side of markets caused by overregulation, state intervention, high taxes, and a welfare state that had been extended too far. The central problem was seen as state failure, not market failure. From the Ordoliberal perspective, the state had not confined itself to its proper task: establishing an institutional framework for ensuring the preconditions of a smoothly working market economy. Instead, it had vastly extended the range of its activities, systematically impairing markets and producing observable negative effects on growth and employment.

By extending the thick net of labor regulations in the 60s and 70s, German labor markets lost much of their flexibility (see generally Soltwedel et al. 1990; OECD 1999, 98–148; Paqué 1999). In part, this was due to the corporatist system of industry-wide collective bargaining that was largely guaranteed by the German constitution. The collective bargaining system allowed the trade unions to impose minimum wages above market-clearing equilibrium wages, and to impose wage uniformities that reduced occupational and regional wage flexibility (Monopolkommission 1994, 360–80).

These rigidities were aggravated by many regulations, such as the strict rules of the German Dismissal Protection Law, which made German employers reluctant to offer new jobs because of the high cost of dismissals (Rüthers 1996, 51ff.; Geue and Weber 1998, 306). Another problem might have been the introduction of a far-reaching system of labor codetermination in large firms in 1972. Although trade-union wage demands became more moderate in the 1980s, indirect labor costs had reached 81.80 DM for every 100 DM in direct labor costs (Institut der Deutschen Wirtschaft 1999b). Unemployment became increasingly persistent, and more and more of the unemployed remained jobless for long periods (Eekhoff 1998, 7ff.).

Many German labor-market regulations were conceived as instruments for the protection of "socially weak" groups and can therefore be interpreted as being part of the redistributive welfare state. But the German system of social security for the middle class was also expanded to an unprecedented extent. The benefits of German statutory old-age insurance, health insurance, and unemployment insurance were considerably increased, and the eligibility of recipients broadened. Consequently, social security "contributions" rose from 8–10 percent of GNP in the 50s to 17 percent during the 80s, reaching 19.3 percent in 1997 (BMA 1998, 7.6). This was the main cause of soaring indirect labor costs, and the benefits for which these contributions paid created negative incentives

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for their recipients to take up the low-paying jobs (Eekhoff 1998, 196ff.) that are often the first steps out of poverty and toward long-term employment.

Even as employment was being discouraged, unproductive industries were being subsidized. In 1997 the total volume of industrial subsidies reached 291 billion DM, or 8.1 percent of GNP and 36.5 percent of total tax revenue. The main sectors profiting from subsidies were agriculture, mining, transportation, and housing (Boss and Rosenschon 1998; Giersch, Paqué, and Schmieding 1992, 216ff.). In slowing down necessary structural changes by propping up unsustainable jobs, German internal subsidies substituted for external protectionism (Giersch, Paqué, and Schmieding 1992, 227).

As a consequence of these policies, public spending increased rapidly after the 1960s, leading both to higher taxes and growing budget deficits. The public-sector share of the GNP (including social-security expenditures) rose from less than 30 percent in the 50s (Giersch, Paqué, and Schmieding 1992, 219) to 50.1 percent in 1982 (Institut der deutschen Wirtschaft 1999a, 86). Since a growing proportion of the rising tax burden was met by direct taxes, especially progressive income taxation (Giersch, Paqué, and Schmieding 1992, 219), there can be no doubt that in the late 60s and especially in the 70s, supply-side conditions had worsened considerably, especially in light of the simultaneous growth of labor-market regulation and welfare-state benefits.

Yet the policies of the social-liberal coalition cannot be seen as a real break with the past. The basic principles of the German social-security system are today in many respects still surprisingly similar to those of the system that Bismarck introduced in the 1880s: health insurance, accident insurance, and pensions for the disabled and elderly (Frerich and Frey 1993, 95–101). For more than a hundred years this system of obligatory insurance has been extended step by step to encompass more recipients and to give them more benefits. This state-based system of social security was explicitly reconfirmed in the early 50s, and while the extension of the system in the late 60s and 70s was a considerable further step that overstrained the German economy, it was not a break in the development of the German welfare state. The same is true for the labor market. The system of collective bargaining among trade unions and employer associations dates back to the beginning of the Weimar Republic, was reestablished in the Collective Agreements Law of 1949, and was reconfirmed by the new German constitution. The Dismissal Protection Law was enacted in 1951, and was only intensified by the so-

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cial-liberal coalition in 1973. In the same way, the 1976 expansion of labor involvement in management has to be seen as part of the German tradition of works councils dating back to the Weimar Republic and especially to the "parity codetermination" in the German coal, iron, and steel industries that began in 1951 (Frerich and Frey 1983; Hentschel 1983).

The Intractability of German Economic Problems

Since the Social Democrats were not willing to reduce their commitment to state intervention, the Free Democratic party changed its coalition partner in 1982, leading to the long phase of the conservative-liberal government under Helmut Kohl, lasting for 16 years. Only after Kohl's electoral defeat in 1998 was a new coalition of Social Democrats and the Green party formed, led by Helmut Schröder.

The new conservative-liberal government that took office in 1982 promised to resolve the unemployment problem in Germany by strengthening economic growth through a more market-oriented economic policy animated by Ordoliberal, supply-side economics. But while neoliberal thinking became increasingly dominant in policy discussions, and Keynesian demand management virtually disappeared in the 80s (Giersch, Paqué, and Schmieding 1992, 195), the new coalition fully participated in the broad social consensus around the need to maintain the German welfare state. Reforming the welfare state and labor-market regulations was understood as part of an overall need for a policy of liberalization and deregulation, but this policy was rather slow and cautious. In comparison with changes undertaken by the Reagan, Thatcher, and New Zealand administrations, the Kohl government was timid. Corrections to the German system of social security were deemed necessary, but the government never planned major reforms.

Therefore it is no surprise that several problems have remained unsolved despite many reform attempts, some of which were carried out while others were not.

For one thing, German old-age insurance is a pay-as-you-go system that is at the mercy of demographic changes. Since in Germany, as in many other industrialized countries, the number of children has declined considerably since the end of the 60s and the life expectancy of pensioners has risen, it has been known for more than 20 years that the ratio of pensioners to contributors will increase dramatically in the fu-

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ture, leading either to considerably reduced pensions for the current generation of employees or to soaring rates of "contribution." These problems have been aggravated by high unemployment and the extension of benefits to newly entitled groups. The rate of pension exactions has already reached nearly 20 percent of gross income, with employers and employees each paying half. To cope with demographic changes, pension extractions will have to reach 30–35 percent in 2030 (Börsch-Supan 1998, 139), leading to even higher indirect labor costs and the further discouragement of job creation. The relatively timid reforms of the Kohl government, which never questioned the pay-as-you-go system, will at best alleviate the problem temporarily (see Siebert 1998; Börsch-Supan 1998; Sachverständigenrat 1999, 180–83).

A second major problem is the skyrocketing cost of the German health-care system. New laws are regularly enacted to limit expenditures, but no sustainable solution has been found (see generally OECD 1997, 67–117). Despite the fundamental problems with the pay-as-you-go pension system, an additional pay-as-you-go insurance system for long-term health care was enacted in 1995 despite wide support among economists for an actuarially sound capital-funded system of private insurance (Eekhoff 1998, 164–74).

Similarly, while many attempts have been made to reform the tax system, only marginal changes, such as a slight reduction in the top marginal income-tax rate, have been enacted. All proposals to extend the tax base by eliminating the many exemptions have failed, as have efforts to end the investment and employment disincentives produced by Germany's highly progressive taxes on middle- and higher-income earners and its corporate tax rates, which compare unfavorably to those of other countries. Rising public debt now makes such reforms even more difficult (Eekhoff 1998, 238–49; Sachverständigenrat 1998, 220ff.; OECD 1999, 49–69).

At the beginning of the 1980s the Kohl government did pursue small measures of privatization and deregulation, and it managed to reduce the share of the economy devoted to the public sector from 50.1 percent in 1982 to 45.8 percent in 1989 (Institut der deutschen Wirtschaft 1999a, 86). But while more than two million new jobs were created in the 1980s (Sachverständigenrat 1994, 257), unemployment remained high throughout the decade due to demographic changes and the failure to enact major liberalizing reforms, and economic growth remained sluggish, averaging 1.9 percent between 1980 and 1989 (see Giersch, Paqué, and Schmieding 1992, 4 and 207ff.). Only the policy of the

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Deutsche Bundesbank turned out to be a full success, reducing inflation to nearly zero in the 1980s (ibid., 12).

The conservative-liberal reforms were too inconsequential to prepare Germany for the new and unprecedented challenges of the 1990s: German reunification, European integration, and globalization.

The Mixed Results of German Reunification

At the end of the 1980s East Germany's centrally planned economy was bankrupt. Consequently, reunification can be seen as a rational economic strategy for the East Germans. Less than eight months after the fall of the Berlin Wall on November 9, 1989, East Germany's economy was incorporated into West Germany's social market economy through the German Economic, Monetary and Social Union (July 1, 1990), followed by political integration in October 1990.

The East German economy suffered from very low productivity due to a systematic neglect of investments, and its products were not competitive in Western markets. This became immediately visible through the quick introduction of the German Mark in East Germany (Giersch, Paqué, and Schmieding 1992, 256ff.). The politically chosen and economically inaccurate conversion rate of 1:1 for rents and wages, and the pressure for equal wages in East and West Germany, led to rapid wage increases and therefore a cost explosion for East German firms in the beginning of the 90s, preventing the East German economy from adapting itself to the conditions of the Western market. As a result, most East German industries collapsed (Franz 1999, 381ff.), and subsequent privatization policy failed to diminish East German unemployment, despite large subsidies for the maintenance and restructuring of enterprises. The German government tried to revive East Germany by transferring huge sums to its infrastructure, and partly through tax exemptions for East German investments. Moreover, East Germans were incorporated at once into the West German system of old-age, healthcare and unemployment insurance. The results have to be seen as mixed (Sachverständigenrat 1998, 210ff.). Large parts of East Germany have received an entirely new infrastructure and the standard of living of the East German population is much higher than before 1989. On the other side there is still very high unemployment—18 percent in 1998 (Franz 1999, 382)—which, despite an intensive application of labor-market policy measures and huge transfers and subsidies, seems to be

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persistent. East Germany will have a long way to go before its economic inferiority to West Germany disappears (e.g., Sachverständigenrat 1999, 72–84).

Neither the rapidity of the reunification process, the politicized currency conversion rate and wage increases, or other problems can be discussed here in detail (see Sinn and Sinn 1992; Gerling 1998; Hunt 1999). What can be said is that within a few months, the whole system of West Germany's social market economy, with its dense net of regulations and its complex redistributory welfare state, was slipped over East Germany, which meant additional impediments to investment, especially because the administration for this system had to be built up from scratch. Meanwhile, paying for reunification has put great financial pressure on both the German budget and the social-security system, aggravating the already existing problems dramatically. Taxes had to be increased and the public-sector share rose above 50 percent of GNP during the 1990s (Eekhoff 1998, 238). The central problems facing Germany are the same now as in the 80s: reform of the old-age insurance and the health-care system, of labor-market regulations, of taxes; and reductions in budget deficits and public debt. But this is no real surprise, since reunification distracted attention from the problems of the West German social market economy for years, delaying the necessary reforms, even as it increased their urgency because of the financial strain of the huge transfers to East Germany.

The Challenge of Globalization

Due to liberalization in many countries and technical progress in transportation and communication technologies, the mobility of individuals, firms, and especially capital have increased rapidly. As a result states, which can be seen as offering complex bundles of public goods (including law, regulations, infrastructure, social security) and taxes, find themselves in competition with one another as locations for investments and therefore jobs. Those countries that succeed in producing especially attractive conditions for the establishment of new production sites are able to induce the influx of capital, helping to foster economic growth, reduce unemployment, and increase tax revenue (Kerber 1998). Since Germany has not been able to carry out real reforms, the international competitiveness of Germany as a location for foreign investments is deemed unimpressive, leading to a comparatively low level of foreign

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direct investment in Germany. Among German economic-policy elites, it is increasingly suggested that fundamental reforms of Germany's social market economy are necessary for regaining competitiveness (Sachverständigenrat 1995; Siebert 1995).

Yet with the rise of the European community, many of the policies that determine the institutional framework within which the market process takes place are made at the international level. In some respects, the EC stands for a strictly market-oriented approach, as exemplified by both the Single European Market Program and the widely successful liberalization and deregulation program. On the other hand, the EC has many powers that it already uses or can use to impose further regulation and intervention. The Common Agricultural Policy, the huge EC programs of research and technological development, and the EC structural funds, with their broad distribution of subsidies, are examples. Thus, even while there has been deregulation and privatization in specific sectors (e.g., telecommunication) and while, as a consequence of the Single European Market Program and the general process of globalization, a huge restructuring has taken place as German industries have adapted themselves to European and global markets, German firms also have become increasingly mobile, implying the danger of exporting jobs to other areas, such as the Middle East and Eastern Europe, where wages are low. This makes it especially disadvantageous that Germany has been unable to solve its huge tax, social-security, public-debt, and labor-market problems. At the beginning of the 1990s, Giersch, Paqué, and Schmieding (1992, 273) pointed out that Germany "lagged well behind the Anglo-American world in its efforts to give its economy a more supply-friendly incentive structure through tax reform and a less stifling system of regulations." This is still true, despite the fact that the OECD has repeatedly demanded reforms, especially in regard to the flexibility of labor markets (OECD 1996, 98–148; OECD 1999, 93–100; Sachverständigenrat 1999, 165–80).

In some respects the problem is political. The need to assemble coalition governments, and the fact that the second chamber of parliament is usually dominated by the opposition, implies that major reforms require great political consensus (unlike, say, in the United Kingdom). This problem is aggravated by politically strong interest groups and the quasi-corporatist German system of collective bargaining with strong unions, which until recently blocked all major reforms of the labor markets. In addition, the German population has been very reluctant concerning fundamental reforms, especially in regard to the traditional

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system of social security. Only recently has awareness that fundamental reforms might be inevitable spread widely.

There seems to be considerable empirical support for Giersch, Paqué, and Schmieding's view (1992, xi) that market-oriented policies accounted for the postwar "German miracle," while subsequent overregulation and the overextension of the welfare state, funded by high taxes, with their disincentive effects, weakened economic growth. The high growth rates in the 50s and early 60s can be traced back to the unleashing of market forces by the postwar establishment of a market economy through internal and external liberalization. The economists also have good arguments that the decline in economic growth and the inability of the German economy to solve the aggravating problem of high unemployment has had its cause in the massive deterioration of supply-side conditions since the beginning of the 70s, especially through the extension of the regulatory and redistributive state. Despite the turn of the Kohl government to a more supply-side oriented policy at the beginning of the 80s, market-oriented reforms were too slow and unambitious to solve the many problems that had piled up in the previous decades.

But does this mean that the German attempt to integrate a real market economy, in the Ordoliberal sense, with elements of a more interventionist state—leading to the concept of the "social market economy"—was wrong from the outset? It is much more difficult to answer this question. Both the corporatist system of collective bargaining and the state-based system of social security were already in place during the "economic miracle" of the 50s, and it is not undisputed why these institutional arrangements have been the cause of economic problems since the 70s but not before (see, e.g., Giersch, Paqué, and Schmieding 1992, 71ff. and 154ff., for the difficulties in explaining moderate union behavior in the 50s and 60s). And even if one rejects the idea that the German welfare state might have fostered the overall efficiency of the German economy by providing social peace, it is possible to argue that the welfare state might have been politically necessary to gain the consent of the population to the establishment of a market economy in Germany.

Finally, there is the view that consent is not only strategically but normatively important: that the preferences of the people should be systematically taken into account. From this perspective the deep-rooted preferences in Germany for the safeguarding of a relatively high minimum income for each member of the society or for other "social"

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aims should be taken seriously. This leads back to the crucial, and open, question of the extent to which the welfare state is compatible with a free-market economy.

NOTES

1. A different assessment can be found in Abelshauser 1983; also see Giersch, Paqué, and Schmieding 1992, 40ff.
2. For discussions of Ordoliberalism/the Freiburg School of Law and Economics see Vanberg 1988 and 1998), Peacock and Willgerodt 1989a and 1989b, and Streit 1992. Translated articles of Eucken, Böhm and Röpke can be found in Peacock and Willgerodt 1989b; most important, but not translated into English, is Eucken 1952.

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Jeffrey D. Milyo and Jennifer M. Mellor

IS INEQUALITY BAD FOR OUR HEALTH?

ABSTRACT: *A number of recent studies suggest that income and social inequality (as opposed to poverty itself) have detrimental consequences on people's health. These studies argue that while the poor may suffer the most from inequality, the rich also suffer. On closer inspection, however, it emerges that the basic arguments and evidence that inequality has a causal effect on health are wanting in many respects.*

In a flurry of recent publications in high-profile journals, several prominent scholars have argued that inequality, and in particular income inequality, is a primary cause of poor health in developed countries. This "inequality hypothesis" has fast become conventional wisdom among many medical sociologists and public-health scholars. For example, in *Unhealthy Societies: The Afflictions of Inequality*, Richard G. Wilkinson (1996) argues that income inequality is "one of the most powerful determinants of health" and "the most important limitation on the quality of life in modern societies." Others echo these claims, albeit with a bit more reserve. Ichiro Kawachi, et al. (1997) describe income inequality as an "important public health problem," while Leyui Shi, et al. (1999) state that "there is little doubt that social conditions in general, and income inequalities in particular, are key determinants of health."

The academic world is by no means immune to fads, but the sudden popularity of the inequality hypothesis is quite remarkable. The

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first published studies to argue for a causal connection between income inequality and individual health appeared in 1992; these were followed, in short order, first by Wilkinson's book, and then by well over two dozen research studies and commentaries in leading journals.[1] Many of these studies provide evidence that is consistent with the inequality hypothesis, but the enthusiasm of many researchers goes well beyond what might be warranted by the weight of the evidence alone.

It may be that some part of the appeal of the inequality hypothesis is attributable to its policy implications. The possibility that inequality has important health consequences opens a new front in the public debate over distributive policy. Egalitarians have long been frustrated by what they consider to be only cursory attempts at redistribution in most developed countries, especially in the United States (e.g., Frank 1999). It is therefore relevant to note that there is some evidence that Americans are less tolerant of inequality in access to health care than they are of inequality in income or wealth (Schlesinger and Lee 1993). As the ongoing policy debate over health-care reform in the United States demonstrates, many Americans consider health and health care to be basic human rights. Consequently, concerns over market-driven differences in health seem to have more traction among the general public than concerns over market-driven differences in income or wealth. The notion that income inequality is detrimental to population health is thus a novel and perhaps more compelling argument for redistribution.

Policy makers and others have begun to take notice. For example, Tony Blair has stated that "there is no doubt that the published statistics show a link between inequality and health." The World Bank has dedicated a web page to the inequality hypothesis (www.worldbank.org/poverty/inequal/abstracts/health) and, in the United States, the National Institutes of Health (Persons 1997) and the Federal Reserve Bank of San Francisco (Daly and Duncan 1998) have jumped on the bandwagon; Harvard's School of Public Health even offers a graduate course on inequality and health. Not surprisingly, the mainstream press has also picked up on this story; for example, favorable articles on the inequality hypothesis have appeared in the *New York Times* (Pear 1996) and the *Washington Post* (Lardner 1998 and Trafford 1999). But a review of the arguments and evidence for the inequality hypothesis reveals that skepticism is in order.

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The Inequality Hypothesis

Few would argue with the notion that an improvement in the material well-being of the poor will produce better health outcomes for that group, but the inequality hypothesis says something very different. The basic claim is that living in a society marked by strong economic and social gradations is akin to being exposed to an environmental pollutant, so that all people, regardless of their wealth or social position, run a greater risk of illness. Of course, just as in the case of air pollution, though all individuals are exposed to some extent, the poor may well suffer the most; nevertheless, according to the hypothesis, it is not deprivation but inequality as such that is unhealthy, and not just for those who are poor.

Investigation of what might causally link inequality and poor health has not progressed much beyond conjecture. In time this may change, but for now two separate mechanisms have been posited, though these are by no means mutually exclusive.

The first is fairly straightforward; Wilkinson (1996) argues that people judge their lot in life by comparing their situation to that of others around them. The greater are income and social inequalities, the more aware are the less well-to-do of their low social status. This creates stress, which is in turn associated with a greater incidence of cardiovascular disease, depression, and so forth. In this way, inequality is a cause of health problems among the poor; however, to the extent that stress and depression make individuals more likely to be involved in accidents or more likely to commit violent crimes, the detrimental effects of inequality may well spill over to the population at large.

Ichiro Kawachi and Bruce P. Kennedy (1999) suggest a more complicated connection between income inequality and health; they argue that inequality hinders the formation of social capital, which in turn is thought to have profound implications for health outcomes. Loosely speaking, social capital is a catch-all term for the level of trust, public mindedness and cohesion in a community; activities such as voting, participation in voluntary organizations, and support for social spending have all been cited as the product of social capital.[2] To the extent that inequality highlights actual or perceived differences across individuals, it may reduce trust and hamper cooperation. This breakdown in community cohesion may, in turn, influence political decision making, leading to inadequate investment in public goods (e.g., education) and little so-

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cial provision for the well-being of the poor. Moreover, a dearth of social capital may leave people feeling isolated and vulnerable, which may also lead to increased stress or psychological depression. So, once again, inequality has a more direct effect on the poor, but spillover effects for the whole community may occur through the pathway of inferior public education, as well as by means of accidents and crime.

While theoretical explanations for the inequality hypothesis are still somewhat amorphous and speculative, they are not so implausible that the hypothesis should be dismissed out of hand. Therefore, our next step is to review the empirical evidence for a psychosocial connection between inequality and health. This evidence is comprised of three distinct types of claim that, when taken together, appear to provide fairly strong support for the income-inequality hypothesis.

First, some scholars argue that social and economic characteristics such as education, and especially income, exert a powerful and independent influence on individual health. This alone is insufficient to establish inequality as detrimental to health, but to the extent that such factors are proxies for social status, they may exert a baneful influence on the health of those at the bottom of racial, educational, and income hierarchies. On the other hand, it may simply be that such factors determine an individual's material welfare, and that it is material welfare that influences health through the causal pathways of lifestyle and access to care. It is therefore crucial to the inequality hypothesis that relative differences in material well-being, not just the absolute levels, affect health.

Evidence for the causal effect of relative rather than absolute differences comes from three types of studies. First, Wilkinson (1992 and 1996) argues that differences in national income do not correlate with differences in population health in developed countries. This would seem to suggest that absolute material standards are not the primary cause of differences in population health within the developed world. It is then quite plausible to conclude that the observed differences in health across socioeconomic groups within any given country must be the product of relative rather than absolute differences.

The second type of research that suggests the importance of relative factors consists of studies such as those that document health differences within the British civil service. These studies consistently demonstrate that health outcomes are better for individuals in the upper tiers of that particular social hierarchy. Similar patterns have been found to exist across dominant and subordinate animals in groups of laboratory mon-

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keys, as well as among wild baboons. Of course, this alone doesn't demonstrate that social rank affects health, but it is consistent with that possibility.

The final variety of empirical research provides the most direct support for the inequality hypothesis, while at the same time offering the only evidence that inequality is detrimental to the health of all members of society, not just the poor. According to this research, income inequality, measured across countries, states, or metropolitan areas, is correlated with poorer population health. By itself, this observation is not very compelling, since it is possible that the correlation between inequality and health is spurious, not causal. But in concert with the aforementioned findings, it lends credence to the view that inequality has important psychosocial affects on people's health.

The arguments and evidence that we have thus far laid out present the case for the inequality hypothesis. Below we examine the evidence and the inferences drawn from it more closely.

Social and Economic Determinants of Individual Health

Even a casual review of the *American Journal of Public Health* reveals that much of the content of this journal is devoted to the study of social and economic determinants of individual health. From segregation in housing to spending on elementary education and even campaign finance reform, there are few social problems that have not been described as having some indirect health effects.

This literature is vast, so we will not attempt to provide a comprehensive review of its findings. Instead, we will accept that for the most part that these studies confirm that material well-being and social status, by any measure, are strongly correlated with health; in general, the more well-to-do a person is, the better is his health. This tends to be true whether one measures health by life expectancy, age-adjusted risk of specific causes of death, or self-reported health status.

One reason for this observed relationship, however, is the failure to control adequately for a variety of observable factors directly correlated with wealth. For example, the wealthy can afford better health insurance and higher-quality health care. At the same time, the wealthy may be more able to enhance their health by consuming more nutritious diets, driving safer cars, demanding better working conditions, living in less polluted or dangerous neighborhoods, and enjoying more opportu-

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nity for exercise or stress release. Similarly, higher-income and better-educated individuals may have easier access to information about the health consequences of certain behavior (e.g., smoking or a sedentary lifestyles). For all of these reasons, there is no controversy over whether improvements in absolute living standards produce improvements in population health (although there is disagreement over the extent of such improvements).

While socioeconomic indicators are thus likely to correspond to absolute levels of material well-being, they may also be informative about relative well-being. It is therefore possible that the well-established relationship between socioeconomic status and health is, as the inequality hypothesis claims, primarily a manifestation of the importance of relative factors (e.g., psychosocial consequences of inequality), and not absolute factors (e.g., poor nutrition, inadequate shelter, lack of access to medical care).

Another reason for the association between economic or social status and health, however, is that poor health may hinder one's educational and career opportunities and income and wealth accumulation. James P. Smith (1999) describes two ways by which poor health can affect wealth: illness can increase out-of-pocket medical expenses, and it may also limit earning capacity. Though identifying the size of the health effect on wealth requires complex methodologies, the available evidence lends support to the view that poor health adversely affects socioeconomic status, not the other way around.

Yet another explanation for the observed correlation between socioeconomic status and health is that both are caused by some underlying third factor that is difficult to observe or measure. For example, it may be that individuals with great self-control and foresightedness both choose to acquire more education and are more successful in school; this heightened awareness of future outcomes could translate into both better income-earning potential and reduced propensities to engage in unhealthful behavior such as smoking (see, e.g., Farrell and Fuchs 1986; Evans and Montgomery 1996). Foresight may similarly reduce the probability that an individual chooses to overeat, abuse alcohol or drugs, or otherwise jeopardize her health. In this conception, the poor tend to have poor health because of the personality traits that make them poor, not because they are poor.

Thus, there are at least four possible explanations for the frequently observed correlation between socioeconomic variables and measures of health: wealth effects, psychosocial effects of relative deprivation, reverse

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causality, and spurious correlation attributable to underlying third variables. It is therefore not surprising that socioeconomic factors are correlated with health measures. Unfortunately, little effort has been made at discerning which explanation is most responsible for the link between socioeconomic status and health. A handful of researchers are now taking on the issue of causality in this context (e.g., Ettner 1996, Ellen 1999, Levy 1999, and Meara 2000), but for the present, the vast literature on social and economic determinants of individual health is by itself quite uninformative about the extent to which these factors are causally related to health, let alone whether relative socioeconomic status is more important than absolute material well-being.

Other Evidence on Absolute versus Relative Factors

Wilkinson (1992 and 1996) argues that the salutary effects of improvements in absolute living standards have been exhausted in the developed world. He acknowledges that economic growth may still be important for population health in less developed countries, but contends that because of diminishing marginal returns, this is no longer true in developed countries. As evidence for this claim, Wilkinson shows that there is no correlation between gross domestic product and age-adjusted mortality across several developed countries. From this finding, he concludes that absolute material living standards are not responsible for the association between individual income and health; rather, he contends, this association is attributable to the psychosocial effects of relative deprivation. But even if wealth-related factors do not explain the link between socioeconomic status and health, there are other possible explanations (reverse causality and third factors). And there is a more fundamental problem with Wilkinson's claim: it is contradicted by a host of more comprehensive and sophisticated statistical studies (e.g., Pritchett and Summers 1996). Wilkinson has already been taken to task for his idiosyncratic analysis of the statistics (Smith 1999), so we will only remark that while it is true that the health benefits of economic growth are more dramatic in less developed countries, it is incorrect to assert that economic growth is unrelated to population health in developed countries. This does not mean that relative factors are unimportant to population health, but that absolute wealth is important, too.

A key component of the inequality hypothesis is that relative differences in income and social status increase the stress levels of those in

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the lower tiers of the social hierarchy, while stress is, in turn, associated with hypertension and mental illness. The landmark Whitehall study collected data on the health of 17,000 British civil servants; this is an interesting group from which to infer the effects of socioeconomic inequality on health, because the civil servants examined have arguably similar education and income levels, as well as similar access to medical care.

From these data, it has been well documented that lower-grade officials have much higher age-adjusted mortality rates than their superiors, even after controlling for different health risks from smoking and the like (e.g., Marmot 1996). Wilkinson (1996) and others have therefore cited analyses of the Whitehall study as particularly compelling evidence that relative social status has dramatic effects on individual health. However, this inference ignores the fact that an individual's place within the ranks of the British civil service is not random. Poor health itself could influence an individual's initial placement in the hierarchy, as well as affecting future placement by limiting the potential for promotion. Further, some third factor (e.g., prudence) may be responsible for both an individual's rank in the hierarchy and that individual's mortality risk. So while the Whitehall study offers fairly convincing evidence that rank in a social hierarchy is correlated with poorer individual health, it does not demonstrate that either rank in the hierarchy or the existence of a social hierarchy is a cause of poorer health.

But suppose that rank in a social hierarchy really does influence health; the mere fact that high-grade civil servants are more healthy than their low-grade counterparts does not imply that the effect of the hierarchy is the one predicted by the inequality hypothesis. The same observed correlation would arise if the existence of a hierarchical structure were actually good for everyone's health, but *particularly* good for those in the top tiers. Like the legendary rising economic tide that lifts the boats of the poor even if it lifts those of the rich higher, social hierarchy may be differentially good for everyone.

One shortcoming of the Whitehall study is that it is impossible for researchers to manipulate the social hierarchy under controlled conditions and thereby isolate the posited causal effects. But this can be done with animals. Wilkinson (1996) claims that studies of monkeys and baboons confirm that social rank causes health consequences. While it is true that studies of lower primates suggest that rank in a social hierarchy is associated with certain physiological responses (e.g., Sapolsky et al. 1997), experiments that explicitly manipulate primate hierarchies do

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not consistently support the inequality hypothesis. For example, Coral A. Shively and Thomas B. Clarkson (1994) find that artificially lowering the social rank of female monkeys (by adding more dominant females) did increase arteriosclerosis in the formerly high-ranking females, but increases in coronary disease were found in monkeys that were artificially moved up in the social hierarchy, as well. This study might therefore be interpreted as evidence that social engineering (rather than social hierarchy) is harmful to health. Nevertheless, Kawachi, Kennedy and Wilkinson (1999) view this research as important corroborating evidence for the inequality hypothesis.

Income Inequality and Health

It has long been recognized that there is a negative statistical association between income inequality and aggregate health outcomes across countries (e.g., Rodgers 1979), but only more recently did researchers begin to argue that this correlation is evidence of a causal relationship (Waldmann 1992 and Wilkinson 1992). It is also well known that in international comparisons, the association between inequality and population health is not robust when different measures of inequality or health are used, different time periods are examined, or other control variables are included (e.g., Le Grand 1987, Judge 1995, Mellor and Milyo forthcoming). However, concerns about the quality of international income-inequality data are such that probably not much weight should be placed on any of these findings, one way or the other.

Studies of income distribution among U.S. states that confirm a negative association between inequality and health are more reliable (e.g., Kaplan et al. 1996 and Kennedy et al. 1996). Initially, it was thought that this statistical association between inequality and health was quite robust across different measures of income inequality and health outcomes (Kawachi and Kennedy 1997). However, subsequent research has revealed that this association may disappear altogether depending on the year examined and the inclusion of other control variables (Daly et al. 1999, Deaton 1999, Deaton and Paxson forthcoming, Meara 1999, and Mellor and Milyo 1999 and forthcoming).

Two regularities emerge from this literature. First, while few studies explicitly test whether inequality has a more pronounced effect on the health of the poor, of those that do, the results are at best mixed (e.g., Daly et al. 1999, Kennedy et al. 1998, and Mellor and Milyo 1999a).

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Second, of those studies that employ data on individual health outcomes, it is consistently found that controlling for individual characteristics (such as income, education, and race) attenuates or eliminates the association between inequality and health (Daly et al. 1999, Kennedy et al. 1998, Meara 1999, Mellor and Milyo 1999a, and Soobadeer and LeClere 1999). Neither of these findings bodes well for the inequality hypothesis.

One possible line of defense for the hypothesis is that inequality affects health indirectly, by lowering individual incomes and educational attainment (e.g., Mayer 1999), which, in turn, affects health. We address this modified inequality hypothesis in Mellor and Milyo forthcoming. In that study, we argue that if inequality is bad for your health, then changes in inequality should produce corresponding changes in your health. We examine the effects of 10- and 20-year changes in income inequality on age-adjusted mortality across U.S. states. In order to answer the defense of the inequality hypothesis, we do not control for other socioeconomic or demographic characteristics of states. We find no *significant* relationship between inequality and mortality in general, while for homicide mortality we find no *consistent* relationship. And for several causes of death that might be associated with stress or depression (cardiovascular disease, suicide, accidents, and cirrhosis) we tend to find that greater inequality *reduces* age-adjusted mortality.

In a forthcoming study, Angus Deaton and Christina Paxson deviate from the existing literature in an important aspect: they measure inequality within birth cohorts, rather than across states or other geographical units. The rationale for this approach is that people may be more likely to judge their social status by comparison to others at the same stage of life, rather than by comparing themselves to their neighbors. Measuring inequalities within birth cohorts does not, however, improve matters for the inequality hypothesis; Deaton and Paxson actually find a strong salutary effect of inequality on mortality.

* * *

Several prominent scholars have argued that there is overwhelming evidence that inequality is detrimental to health; however, the nature of this evidence is far more ambiguous than has been supposed. The frequently observed correlation between socioeconomic factors and health may be attributable to several causes, so this should not be construed as strong support for the inequality hypothesis. In fact, the association between socioeconomic factors and health outcomes is as much

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evidence that inequality improves the health of the rich as that it harms the health of the poor. Nor do studies of social hierarchies, whether among civil servants or lower primates, demonstrate a clear causal effect of hierarchy on health. Finally, studies that examine the association between income inequality and health produce results that are, at best, mixed. Indeed, given some of the contrary findings in recent work, one could argue that inequality is as likely to improve people's health as harm it.

Wilkinson, Kawachi, Kennedy, et al. have offered reasons why one might expect inequality to cause poorer health outcomes, but could just the opposite be true? It certainly seems plausible that more egalitarian societies are not without stress; equality of outcomes necessitates unequal treatment of individuals, which people may consider unjust. People may bristle at progressive taxes, affirmative action, or other redistributive policies as "unfair." In addition, it is plausible that inequality within a political unit may lead to the greater provision of public goods, particularly if politicians are more responsive to the needs of the well-to-do. For example, if rich and poor use the same schools and hospitals, then the rich may lobby for improved quality of education and medical care, thereby improving the health of all. We raise these concerns only to emphasize that the inequality hypothesis has not been well established on either theoretical or empirical grounds.

NOTES

1. Several of these studies have been reprinted, along with related articles, in Kawachi, Kennedy, and Wilkinson 1999.
2. Glaser, Laibson, and Soutter 1999 discusses the problems of measuring social capital.

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J. Barkley Rosser, Jr.

BETWEEN VIENNA AND CAMBRIDGE: THE RISKY BUSINESS OF NEW AUSTRIAN BUSINESS-CYCLE THEORY

ABSTRACT: *Tyler Cowen's "New Austrian" theory of business cycles is based on risk analysis and the assumption of rational expectations. This contrasts with the Old Austrian view, which questions the feasibility of measuring economic risk. Despite Cowen's admirable eclecticism, the way he applies risk analysis to business cycles suffers from serious inconsistencies, and his use of rational expectations is mistaken in the face of economic complexity—a phenomenon that was accurately understood by the traditional Austrians.*

The last quarter century has seen a proliferation of "new" schools of economic thought. New Classical Economics, New Institutional Economics, and New Keynesian Economics have all had a substantial effect on how economists think. Now New Austrian Economics arrives, in the form of Tyler Cowen's *Risk and Business Cycles: New and Old Austrian Perspectives* (London: Routledge, 1997). Cowen's New Austrianism shares with the more macroeconomically oriented New Classical and New Keynesian schools the assumption of rational expectations, and a desire to revise the ideas of an older school accordingly.

The result compares strongly with the New Keynesian effort, in that what results is something that departs radically from the "old

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school." Indeed, it may well be that the Old Austrian and Old Keynesian schools have more in common with each other than either has with their alleged new versions, which in turn have more in common with each other, and with the New Classical school, than they do with either of these older schools. But newer does not necessarily mean better.

The Austrian School on Business Cycles

The Old Austrian theory of business cycles grew out of the tradition that had developed in Vienna from the 1870s onward, beginning with Carl Menger, although he was less concerned with macroeconomics or business-cycle theory than later Austrian theorists were. Menger's follower, Eugen von Böhm-Bawerk, advanced the idea that capital represents the average period of production, a concept he developed in response to Karl Marx's argument that capital was not an independent (or socially legitimate) source of value. Böhm-Bawerk's temporal definition of capital strongly influenced Ludwig von Mises and thence Friedrich Hayek, who can be seen as having codified the Old Austrian business-cycle theory in the 1920s and 1930s, especially in *Prices and Production* (1931, originally published in German in 1928) and *Monetary Theory and the Trade Cycle* (1933). Hayek actively debated John Maynard Keynes over these matters during the Great Depression.

In these works, Hayek used the temporal perspective on capital to argue that mismanaged monetary policy triggers business cycles. Monetary authorities overstimulate the economy by expanding the money supply excessively, causing interest rates to fall too low. In contrast with Chicago-school monetarists of the Milton Friedman variety, Hayek held that the inflationary effect of this monetary expansion is not the chief culprit, although Hayek was no fan of inflation. The problem is that when the interest rate is too low, it distorts intertemporal prices, in effect pricing the future too high relative to the present. This distorts the intertemporal allocation of production by triggering a binge of overinvestment. Unsurprisingly, the markets eventually realize this and react by going in the opposite direction, pushing interest rates up and liquidating the excess stock of capital (and laying off employees who had worked with that capital stock). In short, the economy adjusts by experiencing a recession or even a depression. Mises had importantly

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prefigured many of these arguments, at one point in the 1920s forecasting the Great Depression in light of what he perceived to be overly expansionary monetary policy.

The Old Austrian explanation of business cycles, then, locates their origin in overinvestment in long-term capital projects due to excessive monetary expansion. Cowen tries to incorporate into this view modern theories of financial risk, with the emphasis shifting from temporality to the idea that *volatile* monetary policy increases riskiness, inducing business cycles. Cowen sees the older approach as violating the assumption that market participants' expectations are rational. The error that Hayek and Mises presume that investors make in response to excessively low interest rates—making too many long-term investments—displays systematic irrationality. In Cowen's telling, by contrast, investors do not make systematic errors in any direction; instead they react to changes in the perceived riskiness of the environment. Monetary expansion that leads in the short run to lower interest rates increases the instability of the economy because it induces longer-term investments (as in the older theory) that are riskier; as well, policy volatility magnifies the perception of riskiness, reducing longer-term investments. Cowen recognizes that this latter effect resemble Keynes's "liquidity preference," whereby perceived increases in "uncertainty" lead investors to hold cash rather than investing it. The main link with the older theory would seem to lie in the argument that longer-term investments are riskier, which means that excessive amounts of them can destabilize the economy and throw it into a recession or depression when they need to be liquidated.

For Cowen, the real sin of discretionary central banking is not overexpansion per se, but unexpected policy variability. But since Cowen quite reasonably assumes that a greater overall degree of monetary expansion is likely to coincide with unexpected shifts in policy, in essence, he, like Chicagoans, favors monetary rules in order to reduce the volatility facing entrepreneurs and other decision makers, especially those contemplating the capital investments that determine the future growth of the economy. In his view, recessions arise when market participants, especially those making real capital investments, perceive risk to have increased and thus lose their Keynesian "animal spirits"—their willingness to invest.

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Keynes on Business Cycles and Uncertainty

Keynes originally argued, against Hayek, that central banks have relatively little power and that the declines in investment seen during recessions arise from more deeply rooted factors, especially the animal spirits of those making capital investments. Whereas Hayek saw the economy behaving smoothly if only monetary policy would be "neutral," Keynes (1936) had no such confidence because he saw exogenous shifts of spending propensities triggering business cycles. In this respect, Cowen combines Hayek and Keynes.

However, on another matter, Keynes more closely resembles the Old Austrian perspective than he does either Cowen's New Austrian view or even, arguably, the recently fashionable New Keynesian view. This matter is the issue of risk that Cowen puts front and center as the key explanatory variable of business cycles. Cowen bases his view on modern financial theory, which assumes that measurable risk is traded off against expected returns by investors who maximize their utilities and possess rational expectations—meaning that they can, on average, accurately forecast the future. Such theories of risk are ultimately derived, through the writings of the Old Keynesian, James Tobin (1959), from Keynes's own work. Keynes argued that the animal spirits of investors would decline in the face of uncertainty. Tobin used this argument to develop modern theories of finance based on measurable risk. But neither Keynes nor the Old Austrians, such as Mises and Hayek, accepted the notion of *measurable* risk except in very limited cases—certainly not, as Cowen does, in understanding economic fluctuations..

There is much to be said for the Old Keynesian/Austrian view. However, I see the problem of ineluctably unmeasurable uncertainty as arising from the complex dynamics of the modern economy (Rosser 1999). Like Thomas Sargent (1993), one of the first economists to apply the idea of rational expectations to macroeconomics, it seems to me that complexity arguments provide a compelling critique of the rational expectations hypothesis. Given that Cowen makes this hypothesis central to his New Austrian theory, this critique creates a serious problem for his approach.

I shall consider this argument from several different perspectives in this essay. First I will examine the fundamental nature of risk and uncertainty in the Old and New Austrian and in some Keynesian perspectives. Then I will more closely inspect the details of how Cowen

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uses the idea of risk to understand business cycles. Finally I will note that although Cowen's reinterpretation may have reduced the distinctiveness of the Austrian model, he has made a serious effort to overcome some apparent defects in the older approach, producing an innovative and open-minded analysis.

Risk and Uncertainty Revisited

If there is a fundamental criticism that an Old Austrian can make against Cowen, it may be that he has fallen into a widely believed error regarding the nature of risk. In making such a criticism the Old Austrian may well join forces with some of the Old Keynesians.[1] What the Old Austrians and Keynes share, along with Chicago's Frank Knight, is a fundamental appreciation for the role of unquantifiable uncertainty. This question leads us inevitably to contemplate the nature of their underlying views of probability theory.

In 1921 both Keynes (1921) and Frank Knight (1921) made similar, although not identical, arguments regarding the nature of risk and uncertainty. Both distinguished between that which was measurable, risk, and that which was not, uncertainty. Both of them emphasized as extreme cases such examples as rolling dice versus longer-run economic forecasting. Both emphasized the situation insurers face in their decision making, where measurable risk makes life much simpler than when one faces true uncertainty—in which case, the best one can do is to guess.

Mises (1963, 105–118) posits something like the same distinction, except that he assigns a considerably larger portion of the probabilistic (stochastic) universe to the category of unmeasurable uncertainty than do either Keynes or Knight. Mises distinguishes between "class probability" and "case probability." The former is the simplest possible situation. To use his example, if there are a certain number of winning tickets to be drawn (presumably with equal probability) out of a larger set of lottery tickets, the "class probability" of winning the lottery is measurable, although one can say nothing about the "case probability" of an individual gambler's chances of success.

Likewise, one can construct an actuarial table describing by different ages the overall mortality pattern of a given population, and by deriving associated probabilities, a life-insurance company can make money. But from such a table one can say nothing about the probability of an individual's death. Mises dismisses the mathematical representation of such

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probabilities as adding nothing to an observer's knowledge of the individual's prospects. Although this may simply reflect his more general antimathematical stance, shared by many Austrian economists, the real heart of the matter is that an individual's circumstances are strictly specific and nonrepeating, so they cannot possibly be assigned any accurate probability.

Mises provides as an example the 1944 U.S. presidential election, noting various statements that one could have made beforehand about the probability of a particular outcome. If one predicts a priori that it is "nine to one" that Roosevelt will be elected, this is simply "metaphorical," having no similarity to the *class* probability—the quantifiable risk—from which insurers profit. Effectively, as the circumstances of a given election will happen only once, it is meaningless to talk about having ten such elections with Dewey winning one of them and Roosevelt winning the other nine. Mises (1963, 117–118) writes that

> praxeological knowledge makes it possible to predict with apodictic certainty the outcome of various modes of action. But, of course such prediction can never imply anything regarding quantitative matters. Quantitative problems are in the field of human action open to no other elucidation than that by understanding.

Thus, he argues, the economist can predict that a fall in demand will be followed by a fall in price, but not by how much.

Mises's protégé, Israel Kirzner (1997), documents how this view evolved through the work of such figures as G.L.S. Shackle (1972), with his vision of the constantly changing "kaleidic economy." The focus of Kirzner's discussion is not business cycles but the entrepreneurial discovery process. Following Mises, he sees this process occurring in an open-ended environment in which agents, afflicted with "sheer ignorance," experience surprise. Kirzner is more optimistic that the discovery process leads to a sort of convergent learning than are Shackle and others, who see the very process of entrepreneurial decision making as constantly redefining the environment and itself generating further uncertainty.[2]

Keynes's view is somewhat more complicated than that of Mises and his followers and is less concerned with the role of entrepreneurs, although sharing important elements, especially the idea that free will is a fundamental source of the unmeasurable uncertainty facing economic decision makers. In his *Treatise on Probability* (1921, 33), Keynes distin-

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guished between four different possible cases, not just the two of Knight and Mises:

> There appear to be four alternatives. Either in some cases there is no probability at all; or probabilities do not all belong to a single set of magnitudes measurable in terms of a common unit; or these measures always exist, but in many cases are, and *must remain*, unknown; or probabilities do belong to such a set and their measures are *capable* of being determined by us, although we are not always able so to determine them in practice.[3]

The first alternative clearly corresponds most closely to Mises's "case probability" (although Keynes seems to be willing to grant the possibility of estimating probabilities in many cases that Mises would not). For Keynes, this kind of fundamental uncertainty relates to the distant future, when human actions can bring about substantial changes in the very nature of the economy and society—as through war, unforeseeable technological change, or systemic restructuring. Keynes's fourth alternative is Knight's potentially measurable risk, which Mises might allow rarely under the rubric of "class probability." The third alternative has been said (by Lawson 1988) to correspond more precisely to Knight's own concept of uncertainty. The issue is the distinction between objective and subjective views of probability, with Keynes holding a more subjective view than Knight's. With that in mind, even though the Old Austrians more frequently refer to Knight's view of uncertainty, it may be that Keynes's first alternative may be closer to their actual position.

The second alternative may be the most subtle of the four. The idea of noncomparability can take several different forms (Keynes 1921, ch. 3). Thus, a series of possible events may be ordinally ranked with respect to each other, but not cardinally ranked with respect to a greater or lesser probability of happening. Or a series can be similarly ranked within itself, even though no pair of events within it and within another series can be compared to each other even ordinally. Or there might be an event that is in both series and can be compared with every event in each series, even while no others can be. Thus, probability distributions, to the extent that they can even be described, may be multidimensional in some sense. This is a point to which we shall return when we discuss Cowen's view of risk, but for now let us note that examples might occur when one compares a "Gaussian" normal distribution, which can be characterized simply by its mean and variance, with one possessing

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"skewness" (asymmetry) or "leptokurtosis" (fat tails). Thus, in comparing a normal distribution with a skewed one, the mean of the latter might be below that of the former, while its median and mode are above those of the former (which would equal the mean).

Hayek (1941, 400) appears to have noticed the similarities between his view of uncertainty and Keynes's:

> Neither risk nor liquidity can be adequately expressed as simple one dimensional magnitudes, since they are both of the nature of probabilities which can be sufficiently described only in terms of the properties of a frequency distribution. This means that, strictly speaking, it is not possible to arrange the various assets in a simple linear order according to the liquidity or risk attaching to them, and that some multi-dimensional arrangement would have to be used instead.

Cowen's New Austrian View of Risk and Business Cycles

Let us turn now to the specifics of Cowen's proposed theory of risk as a way of explaining business cycles. Six assumptions form the core of his argument. The first is that financial analysis shows that investment involves greater risk than consumption. The second is that a decline in the real interest rate will increase investment, ratcheting up risk for each investor (because of the greater riskiness of investment compared to consumption). Third, increases in investment risk for each entrepreneur lead to increases in aggregate risk. Fourth, riskier investments yield higher expected returns in equilibrium. Fifth, entrepreneurs have greater certainty about near-term returns than those in more distant periods. And the final assumption is that an exogenous increase in the real economic risk of investments will induce a contraction of investment, and thus, possibly, a more general economic downturn. The first four are Cowen's core assumptions, with the latter two amounting to working hypotheses.

These six assumptions interact with five possible sources of expansion that can increase the riskiness of the economy and therefore the likelihood of cyclical fluctuations. These are: a willingness to accept more risk due to an increase in animal spirits; a fall in interest rates due to increased savings or expansionary monetary policy; a broader easing of financial constraints; the removal or resolution of some economy-wide uncertainty; and an unanticipated rise in retained earnings from a

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positive technology shock or a Keynesian-style demand shock. In contrast to the older Austrian view, Cowen recognizes the possibility that an induced increase in investment might actually generate a *sustainable* boom, but in the main he argues that more investment intensifies risk and volatility. Eventually one of the five sources of expansion turn around and investment, and the economy, contract.

That these five factors are likely to influence investment in the way Cowen suggests is reasonable. But we should look more carefully at his six assumptions.

The first, regarding the relationship between the riskiness of consumption versus investment, depends on consumption being immediate—a point that Cowen apparently realizes, as he later refers to "immediate consumption" (18) in this context. If consumption is immediate then it is not risky compared to investment, just as a bird in the hand is worth two in the bush. You know what you consume now, but you do not know what your investments will earn in the future.

But in reality consumption is not always immediate, and it is well known that purchases of consumer durables are sensitive to interest rates. One might argue that this is purely because of financing issues and not any riskiness inherent in the nature of consumption and investment due to their time patterns. But just as Cowen argues that nearer-term returns are more certain than farther-out ones, so, too, for the utility stream from a consumer durable. When one purchases such a good as a new car, there is considerable risk about the future stream of utility that it will generate. Is the car a lemon? How long will it function? Will my attitudes about it change? Might the appearance of newer models make me less happy with it?

One might reply that a consumption item at any given moment in the future will be associated with less expected risk than an investment at the same moment. But in fact, a fairly simple short-term capital investment might easily be less risky, by whatever measure, than a consumption purchase of an even longer time horizon. Thus, replacing a worn-out computer with a new and relatively similar one for one's business might easily be a less risky decision than buying a new car.

We shall not question that a decline in the real interest rate will tend to stimulate capital investment, despite the plethora of debates regarding the strength of that effect. However, it is not at all clear that such an increase in investment will raise the risk for each investor, much less for all investors in the aggregate. Indeed, this may be the weakest link in Cowen's entire argument, as the rest of it cannot proceed without it. If

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greater investment does not increase risk for investors, then there is no reason why it should necessarily lead to an economic downturn.

Cowen quite reasonably infers from standard financial theory that there is a tradeoff between risk and rate of return. However, he makes a jump from this inference that is not justified. He argues that as the real interest rate falls, the additional investments provide higher yields than those made at the higher interest rate, leading to his conclusion of rising risk for all involved. (Cowen's argument entails the claim that the lower real interest rate will increase portfolio wealth and thus encourage risk taking, with a shift from safe consumption to riskier investment. He sees this shift as arising from mismanaged monetary policy rather than from capitalism per se, unlike many Keynesians.) This argument regarding the role of the interest rate involves several assumptions, not all of which necessarily hold.

The biggest problem is with the argument that the additional investments will have higher expected yields (presumably higher expected rates of return) than the earlier ones. It is actually quite reasonable to posit exactly the opposite. What is involved here is the demand schedule for investment—what Keynes called the marginal efficiency of the investment schedule. The usual story is that this reflects a prioritized ranking of potential investment projects. In this view, assuming equal risk for all such projects, they will be ranked in exactly the opposite way from what Cowen assumes, with those yielding the highest expected yields being carried out first, even in the face of high real interest rates. As the real interest rate declines, the projects with lower expected rates of return are brought on line as they become potentially profitable. In short, expected rates of return will decline as the interest rate declines. Of course the rate of return investors expect once the interest rate is included in their calculations will rise for all projects as the real interest rate declines, but this effect in no way reflects any change in risk, either for any individuals or in the aggregate.

Now of course Cowen is not assuming the equal riskiness of these potential projects; far from it. Without doubt, when potential projects are decided upon, both their expected risk and their rates of return will be factored in, perhaps in the traditional manner of assigning risk premia that adjust the expected rates of return downwards. But there is no reason whatsoever to expect that these risk premia will be so large for the projects with higher expected rates of return that the entire schedule will be effectively reversed from what it would have been in the case of equal degrees of risk for all projects. In reality, as one moves

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down the priority ranking, one can say nothing about what the expected rate of return of the next project will be compared to that before it, other than that if its expected rate of return is higher, then so must be its perceived riskiness, and vice versa; and that all expected rates of return will exceed the real rate of interest. In effect, Cowen has mistaken an indifference curve for a demand curve. The famous risk/rate-of-return tradeoff is a question of the marginal efficiency of investment schedule—a question of demand.

This whole argument is further muddled by a related complication. Cowen assumes that the prioritized ranking of the potential projects is independent of the real interest rate. But a change in the interest rate will affect different potential projects in arbitrary and unpredictable ways relative to each other, given their various temporal patterns of expected return and risk. The schedule is not well ordered, even if one can assume that more projects will be undertaken as the real interest rate falls. Thus, the outcome may well depend on how the real interest rate changes. A gradual and smooth decline will bring forth a different order, and possibly even a different amount, of investment than will a sudden and sharp drop in the real interest rate to the same final level. In a world of complicated time patterns for net returns, things can get very messy.[4]

Finally, we have the problem that Cowen presents an oversimplified notion of risk, one that does not stand up well to either the Old Austrian or the Post Keynesian critique, much less the more high-powered approaches of modern financial economics. Of course, part of the problem is that he never clearly specifies what he means by risk other than by identifying it roughly with "volatility," although in the last chapter of the book he adduces some empirical studies to support his emphasis on variance in returns.[5]

In effect we are back to the noncomparability problem understood by both Keynes and Hayek. Certainly it is true that simple financial theory assumes unidimensional measures of "risk." But observers of financial markets increasingly understand that this is inadequate. In particular, it is now virtually a stylized fact of most asset markets that they exhibit "fat tails," reflecting the reality of "extreme events" (Loretan and Phillips 1994). Essentially, financial markets experience more severe crashes and more dramatic booms than would be predicted by a normal distribution. Empirical distributions of returns on most assets simply are not Gaussian normal and cannot be characterized just by their means and variances.

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To properly account for "volatility" means accounting for more than just the variance of the distribution as risk. There are complications such as skewedness (the tendency for data to extend farther in one direction than in the other, as with income distribution) and leptokurtosis (the excess prevalence of extreme events in both directions, up and down). One potential project may have a lower variance associated with it than does another, but it may have a greater danger of some very extreme outcomes than does the other, making it seem riskier to the potential investor. Or the perceptive investor may well understand that there is no ranking based on something that can even be characterized as mere risk, although it may be possible to come up with a unidimensional measure out of some combination of the various moments. But such a combination itself may well depend on the real interest rate, as an investor may make different relative evaluations of everyday variance and infrequent extreme events as the real interest rate varies.

The Problem of Expectations

Central to this entire discussion is the question of expectations and how they are formed. Cowen exhibits an admirable willingness to incorporate ideas from other schools of economic thought into his theory, even at the risk of diluting the "Austrian" identity of his theory. But the key idea he imports into his critique of the Old Austrian view is that of rational expectations. Cowen's synthesis of Austrianism and rational expectations produces several problems.

The first is that it is not clear that he has consistently applied the rational-expectations assumption in his own analysis. He puts the Old Austrians in their place for assuming systematic biases in investors' expectations in the face of inflation arising from monetary expansion: it is implausible, he notes, to believe that they consistently overinvest, get burned when interest rates prove to be unsustainably low, and never figure out what is going on. Cowen suggests that their forecasting errors should instead balance out, such that sometimes they will underinvest out of an exaggerated fear of the future consequences of monetary expansion and, therefore, of an unsustainable boom. Not only that, but sometimes monetary expansion will succeed in a Keynesian kind of way in that the overinvestment will prove to be a self-fulfilling prophecy, a boom that successfully induces a higher rate of growth.

Keynes's is a world of multiple growth equilibria, where mutual con-

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fidence works to move the system to a higher and better rationally expected state, although Cowen sees this as an increasingly fragile outcome, based on his argument that larger amounts of investment necessarily entail higher levels of risk sooner or later, leading eventually to cyclical fluctuations. Thus, despite the possibility of self-sustaining monetary booms, Cowen holds that unpredictable variability in monetary policy is the source of problems because it increases risk, which leads to fluctuations. This is the New Classical position. But the claim that expansionary monetary policy will lower the real rate of interest (cf. Butos 1993) sits uneasily with the perfect foresight posited by Cowen's rational-expectations extremism, which would imply no change in real interest rates, as people perfectly anticipate inflation attendant upon monetary expansion, adjusting the nominal rate of interest upwards. Cowen pays no attention to this possibility when he posits a decline in real interest rates arising from an expansionary monetary policy. Even without perfect foresight, however, the rational-expectations assumption implies that real interest rates would be as likely to rise as they would be to fall in the face of unexpected monetary expansion, as people would be as likely to overpredict the increase in the inflation rate as to underpredict it.

The hard fact is that Cowen presents no coherent theory of the real interest rate. He dismisses the "natural rate-of-interest" theory deriving from Wicksell and accepted by some of the Old Austrians in an earlier period (Cowen 1997, 95–96).[6] But he provides no clear alternative. He accepts that a variety of factors might influence real interest rates, from the marginal productivity of capital to monetary policy to the supply of loanable funds determined by savings. In the last of these cases, an exogenous but unexplained increase in the propensity to save presumably results in greater risk for the economy, as there is an increase in investment and a reduction of consumption. But an obvious explanation of a greater propensity to save may be an increase in risk aversion arising from fear of anticipated greater volatility in the economy. This would contradict Cowen's assumption that consumption is less risky than savings (investment). But in fact immediate consumption is risky in that it reduces the ability to consume in the future if future income is volatile. Much saving happens precisely for precautionary reasons, and increasing immediate consumption is rightly viewed by many people as risky behavior. (Such precautionary savings are placed in safe instruments, such as government bonds, rather than being used to purchase some You-Never-Heard-Of-It-Before dot-com stock with no revenue.)

More broadly, the most recent developments at the cutting edges of

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macroeconomic theory have increasingly been calling the rational-expectations assumption into question, as symbolized by Thomas Sargent's (1993) acceptance of adaptive expectations in the face of the ineluctable complexity and unpredictability of economic phenomena. Now, skepticism regarding rational expectations in the light of complexity is a very respectable Old Austrian position that was espoused by Hayek (1967), even before rational-expectations theory was applied to macroeconomics by scholars such as Sargent. Indeed, the idea that entrepreneurs search for profit opportunities in an inherently unpredictable environment is a central notion of the Austrian school; as Mises (1963, 871) puts the point, "If it were possible to calculate the future state of the market, the future would not be uncertain. There would be neither entrepreneurial loss nor profit. What people expect from the economists is beyond the power of any mortal man."

It is profoundly ironic that just as some of the most influential advocates of rational expectations are moving in the direction of Mises and Hayek as well as Keynes, Cowen is rushing in the opposite direction and defending this movement by labeling it "New." Nevertheless, it must be admitted that his criticism of the standard Old Austrian assumptions regarding the nature of investors' expectations biases in the face of monetary expansions must be taken seriously. It is just that Cowen's use of rational expectations is itself neither especially consistent nor convincing.

The faults I have claimed to discover in Cowen's analysis are, of course, shared by many macroeconomic models. From the use of simplistic characterizations of risk to a persistent reliance upon the increasingly unbelievable assumption of rational expectations, it may be that Cowen is pursuing chimeras, but they are popular and widely accepted ones among economists.

Moreover, Cowen's open-minded attempt to link Austrian, Keynesian, and Chicago-school insights does not prejudge the evidence or bend it to predetermined purposes. On the final pages of the book (148–49), Cowen admits that "the results of this endeavor have been decidedly mixed. . . . None of these results . . . discriminates decisively in favor of risk-based (or traditional Austrian) theories as opposed to other potential business cycle mechanisms." Such willingness to face the facts squarely and forthrightly must be admired and respected.

It is unclear whether or not the theory that Cowen presents should even be called "Austrian," given its essentially eclectic nature. But then Cowen is hardly the first to apply a well-known label to a version so

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revised that it may not merit it. The same has been done to the Old Keynesians and the Old Institutionalists. It is perhaps only fitting that the Old Austrians should have their turn as well.

NOTES

1. As already noted, Old Keynesians such as Tobin would not agree with this criticism of Cowen. More likely to do so would be "Keynes-Post Keynesians," most notably Paul Davidson (1994), who has vigorously argued that Keynes considered uncertainty to be ontologically unmeasurable.
2. Others who share Shackle's view on the convergence of entrepreneurial discovery include Lachmann (1976), who in turn influenced Joseph Salerno (1993) and Murray Rothbard (1994). Bryan Caplan (1999) dismisses this whole discussion in a manner similar to Cowen's, arguing that in all these cases one should simply assign probabilistic risk.
3. For extended discussions of these cases and their foundations and implications, see Rowley and Hamouda 1987, Lawson 1988, O'Donnell 1990, and Rosser 2001.
4. Ironically, Cowen (108–14) is aware of the underlying issue here and discusses it in connection with the Cambridge capital-theory controversies, which ultimately arise from the complexities of relative time patterns in net returns. Cowen argues that the issue is irrelevant to his discussion, because it deals with the problem of capital intensity, which he claims to have avoided by emphasizing the role of risk. But this is not so, as he has tied risk to the time horizon of an investment—effectively a measure of its capital intensity, following the Old Austrian emphasis on the period of production. It is exactly the ability to unambiguously rank the relative time horizons of investments that breaks down when their relative patterns of returns become complicated. Cowen denies the empirical relevance of capital-intensity reversal, but Albin 1975 and Prince and Rosser 1985 provide empirical examples. Rosser 1983 argues that the more serious issue associated with capital-intensity reversal is dynamic discontinuity.
5. In the last chapter of his book, Cowen cites Leahy and Whited 1996 in arguing that variance of returns predicts investment levels better than does covariance; he claims that this supports his view of risk and investment. Thus, he seems to dismiss the capital asset pricing model (CAPM) in favor of a simpler view, which may be empirically justified. But basic CAPM is hardly the only alternative.
6. There is no general agreement regarding what the "natural rate of interest" is, even among Austrians. Hayek thought it to be that which would arise from savings and investment made in the absence of any distorting monetary policy. But Mises saw it more as an equilibrium concept related to the capital structure. Other views have emphasized the real marginal productivity of capital and the rate that equalizes *ex ante* savings and investment. By no means do any of these opinions necessarily coincide.

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Karl von Schriltz

FOUCAULT ON THE PRISON: TORTURING HISTORY TO PUNISH CAPITALISM

ABSTRACT: *Michel Foucault has been an academic cause célèbre for some time, spawning untold thesis papers and dissertations illuminating oppression's invisible fingerprints on history, literature, gender, and government. Yet for all his centrality in American higher education, Foucault's books are not studied so much for their substantative content as for their underlying insights into the forces shaping society. This paper confronts this paradox through a critique of the apotheosis of Foucaultian analysis,* Discipline and Punish: The Birth of the Prison. Discipline and Punish *can be understood as a masterful harnessing of leftist assumptions about capitalism to reconfigure history. The extent to which Foucault distorts history to support his thesis, however, seriously undermines the practical relevance of his brand of social science.*

Discipline & Punish (subsequently cited by page number alone) is generally regarded to be Michel Foucault's masterpiece, and as such, represents the best vantage-point from which to criticize his idiosyncratic brand of historical analysis (see O'Brien 1989, 37; Sarup 1989, 73). Foucault himself described it as "my first book" (Merquior 1985, 86). Through his history of the prison, Foucault avowedly sought to forge a new approach to the evolution of institutions, values, and norms. Foucault's approach revolves around his theory that "power"—his term for clandestine social forces—shaped history more decisively than the more visible forces of religion, intellectual currents, or individuals. His

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genealogical method, borrowed from Nietzsche, illuminates power's nefarious influence, and charts its political economy, by cataloguing its external manifestations in institutions, and in the writings of leading thinkers, over time. Indeed, Foucault arguably owes his continuing vogue in American academe not to his contributions to penology, or the study of mental illness or sexuality for that matter, but to his groundbreaking strategy for harnessing history to the cause of leftist social criticism.

This paper argues that Foucault's genealogy of the prison, which embodies his subordination of history to his vague conception of power, can be understood as a scathing critique of capitalism, the glaring inaccuracies of which draw the integrity of his approach into question. "Power" bears an uncanny resemblance to the capitalist efficiency imperative. Foucault's cryptic discussion of power neatly tracks the systemic forces underlying capitalism; industrialization emerged alongside the prison. To make this insinuation, Foucault engages in numerous historical distortions. The history Foucault omits—most notably France's hesitancy to adopt the prison and America's penal experimentation—contradicts his theoretical template.

Understanding Power as Capitalism

In *Discipline and Punish*, Foucault purports to illuminate the fundamental, subterranean forces shaping modern society by disclosing how the evolution of the prison served the changing imperatives of "power": "The history of this micro-physics of the punitive power would . . . be a genealogy or an element in a genealogy of the modern soul" (29). Despite power's centrality, Foucault's elliptical prose does more to obfuscate than clarify its nature: "A soul inhabits [man] and brings him into existence, which is itself a factor in the mastery that power exercises over the body. The soul is the effect and instrument of political anatomy; the soul is the prison of the body" (30).

A key to unlocking "power" is given by Foucault's approving citations (24, 54) to Rusche and Kirkheimer's "great work" *Punishment and Social Structures*, which argues that methods of punishment reflect modes of production. As feudalism gave way to industrial production, this argument goes, modes of punishment came to reflect the need for freer markets. Though Foucault refers to modes of production only

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obliquely, the Marxist framework proposed by Rusche and Kirkheimer arguably represents the analytical foundation of *Discipline & Punish*.

Foucault's preoccupation with docile bodies, the political economy of power, and efficiency all implicitly refer to capitalist imperatives increasingly reflected in society after the Industrial Revolution. Docile bodies (137–38) closely resemble human capital, or bodies whose movements have been disciplined through training and education to respond to market forces. The political economy of power (25) is nearly synonymous with economic competition writ large, or the dynamic process of natural selection that strengthens and undermines social structures according to their economic value. *Efficiency* (145, 148, 152, 163–65) is a term lifted directly from economics—it is capitalism's lifeblood. Market economies are driven by the profit motive towards an efficient deployment of scarce resources—Pareto optimality.

Cast in this light, "power" becomes the invisible hand of market economics. In the pre-industrial era, when trade was sporadic and great wealth was accumulated by force, power was manifested through military might, and military efficiency largely determined a state's wealth. By likening public torture and execution to a military campaign by the king against his enemies (50, 57), Foucault intimates that pre-industrial punishment had an economic value. He indirectly addresses this point by observing that "Rusche and Kirkheimer are right to see [public execution and torture] as the effect of a system of production in which labor power, and therefore the human body, has neither the utility nor the commercial value that are conferred on them in an economy of an industrial type." Thus, the criminal justice system "was not entirely unconnected to the function of war," which was to enrich the king (57).

Foucault next asserts that the efficiency long displayed by the military was increasingly demanded from all of society, because the locus of wealth accumulation shifted from force to enterprise, and the target of crime shifted from bodies to goods. The chapter titled "Docile Bodies" argues that in the name of efficiency, the principles of training and regimentation that long enhanced military efficiency came to be applied in schools, factories, and hospitals (135–36, 138–40). Foucault's "efficiency" is repeatedly related to the sort of efficiency attained on an assembly line by the division of labor: higher labor productivity resulting in higher profits (145,163). Training and education are said to result in workers exhibiting "greater efficiency and speed" (152, 164). The system of justice itself is said to have been shaped in part by a desire to increase its economic productivity (80–81, 87). In this regard, Panopticism is

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nothing more than a metaphor for techniques of increasing human capital that incidentally resemble Bentham's model prison.

By euphemistically referring to capitalism as "power," Foucault is able to launch a backdoor leftist critique of social institutions without recourse to empirical rigor, which has been Marxism's Achilles' heel.[1] Foucault's suggestion that history can be explained in terms of the insinuation of power into people's lives merely reconfigures Marx's assertion that "the history of all hitherto existing society is the history of class struggles" (Marx and Engels 1975, 32). In Foucault's account, however, class appears by proxy: capitalists are the natural beneficiaries and masters of power, while "docile bodies" represent the hapless proletariat who serve it.

Foucault's strategy of scrupulously avoiding the positivist scrutiny invited by Marxism was made apparent when an interviewer asked Foucault "who wields power against whom in a Panoptic system?" to which he responded "This is preoccupying me. . . . This is just a hypothesis, but I would say it is all against all" (89–90). Yet when Foucault is engaged in historiography, he describes not so much a war of all against all as the deployment of power by bourgeois capitalists, who use the state to shape society so as better to exploit the proletariat. Foucault verifies this interpretation in an unusually lucid passage towards the end of *Discipline and Punish*: "Historically, the process by which the bourgeoisie became in the course of the eighteenth century the politically dominant class was masked by the establishment of an explicit code and formally egalitarian juridical framework, made possible by the organization of a parliamentary, representative regime. But the development and generalization of disciplinary mechanisms constituted the other, darker side of these processes" (Foucault, 222).

Discovering History in a Theory

To substantiate his thesis, Foucault strives to show that penalogical developments traditionally attributed to a confluence of disparate factors—religious conviction, scientific inquiries into the nature of punishment and the root causes of crime, and the political influence of reform advocates—actually reflected the changing requirements of power as capitalism blossomed.

Foucault's historical argument can be broken into four parts. First, he asserts that prior to the eighteenth century, public torture and death

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were the primary methods of punishing law-breakers, enforcing law and order by advertising the sovereign's infinite power over bodies. Second, he claims that during the eighteenth century, prison suddenly became the primary mode of punishment, as the focus of criminal justice shifted from physical violence to theft. Execution became counterproductive, Foucault argues, because destitute peasants could too easily commiserate with the condemned. Third, he maintains that throughout the eighteenth and nineteenth centuries, prisons came to reflect the relentless surveillance, rigid regimentation, and silent introspection of Panopticism. Law and order came to be enforced from within the individual, as prisons burned a sense of the state's omniscience into the "soul." Finally, Foucault opines that the prison's failure to rehabilitate, borne out by high recidivism, conveniently acted to transform economically deleterious, but sympathetic, criminals into publicly detested, but useful, delinquents. Each of these four claims will be considered for its historical accuracy in turn.

The Spectacle of the Scaffold

Foucault asserts that prior to the French Revolution, criminal punishments were largely corporal: torture, death, flogging, and banishment (57). While the judicial process itself was secret, torture and execution were public, conditioning subjects to obey their sovereign (35, 47, 57). In this way, torture and execution acted as both visible judicial rituals—creating the illusion of justice—and political ones—asserting the sovereign's infinite power over bodies.

Torture and execution were chosen, Foucault posits, because human bodies were relatively expendable in pre-industrial Europe: they did not make the significant economic contribution they later would in industrial economies (54). Moreover, execution raised few eyebrows, given death's prevalence in pre-industrial quotidian life. (55) Thus, torture and death strengthened the sovereign's hold on society in dramatic fashion at little cost. The reality, however, is that Foucault's historical account greatly exaggerates the frequency of torture and execution and understates the economic value of pre-industrial human bodies.

As a preliminary matter, Foucault admits that the majority of pre-industrial punishments were *not* capital, as judicial discretion resulted in most capital crimes being punished with fines, banishment, or flogging (33). His argument, however, proceeds as though this admission were

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never made: "crime and the punishment were related and bound up in the form of atrocity. . . . It was the effect . . . of a certain mechanism of power . . . [that] was exalted and strengthened by its visible manifestations" (57). Foucault implies that the spectacle of torture and execution was widely disseminated throughout society and burned into the public consciousness (63). This is at odds with the historical record.

By all accounts, public tortures and executions were not very common in pre-Revolutionary France (Wright 1983, 5). One study of punishment in Old-Regime France, based on records maintained in two representative districts between 1696 and 1789, found that only 21.9 percent of guilty verdicts resulted in the death penalty, including only 7 percent of those convicted of aggravated theft (Ruff 1984, 61, 116). More importantly, only six of the 30 recorded executions involved pre-death torture (ibid., 61). Throughout pre-Revolutionary eighteenth-century France, less than 10 percent of convictions resulted in death sentences (Wright 1983, 6). Moreover, there is no reason to believe that more than a smattering of citizens were directly exposed to the spectacle of torture and execution, given the dearth of public transportation.

If public torture and execution were rare in Old-Regime France, they were rarer still elsewhere in Europe. In England, fines, not torture and execution, were the predominant form of punishment between 700 and 1189 (Moynahan and Stewart 1980, 11–14). Moreover, the subsequent era of torture and execution was short-lived, for by 1553, an unprecedented crime wave had underscored the failure of disproportionately cruel punishments to deter crime, and Parliament began experimenting with imprisonment (17–22). German-speaking countries began replacing corporal punishment with imprisonment in the late seventeenth century (Rusche and Kirckheimer 1991, 48). In America, William Penn's Great Law of Pennsylvania abolished the death penalty altogether in Pennsylvania between 1682 and 1718 (Lewis 1922, 10, 13).

Foucault's assertion that the low economic value of citizens in pre-Revolutionary France dictated corporal punishment is similarly unfounded. Most European states began reducing capital punishment long before industrialization, in the seventeenth century, to ease the burden on government (not private) coffers (Lewis 1992, 51). For example, the primary motivation behind the German shift from execution to prison was to defray the cost of administering justice though prison labor. Prisons only later came to be regarded as punitive (Lewis 1922, 51; Melossi 1991, 65). In pre-industrial France, subjects were valued as soldiers and as taxpayers, albeit not as assembly-line workers. As military

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strength depended on manpower, however, most male thieves in seventeenth-century France were not executed but pressed into service as oarsmen on military vessels (Ruff 1984, 60). France's expansive bureaucracy, flamboyant aristocratic lifestyles, and military misadventures were all financed through crushing taxes levied on the peasantry, aided by one of Europe's earliest centralized bureaucracies (Mansel and Winks 1980, 51–52).

Given their rarity, public execution and torture did not likely bolster sovereign power in the minds of the populace in the way Foucault suggests. It is more plausible that such grizzly punishments were meant to create an effective deterrent in an era when most crimes passed undetected and unpunished. Thoughts of execution may have preoccupied would-be offenders, but law-abiding citizens—the target audience of execution and torture, by Foucault's account—probably concerned themselves more with avoiding criminals.

Foucault exaggerates the importance and popular salience of torture and execution to create a pre-industrial benchmark from which to criticize modernity. The bourgeoisie had yet to "rise to dominate the political system," so the proletariat's oppression by capitalism had yet to begin. As the economic value of manipulating bodies had yet to be discovered, Foucault implies, kings derived satisfaction from the exercise of "surplus power" over their subjects' bodies through torture and execution, just as the bourgeoisie would later derive satisfaction from the accumulation of surplus wealth on the backs of the proletariat (29, 49, 53–54). The earlier modality of power is implicitly judged preferable to the latter because it affected human freedom on only a superficial level—by altering behavior—whereas the more recent modality eroded human freedom at a deep level by manipulating the human "soul" (9, 16).

Foucault cannot reconcile the pre-industrial prevalence of exploitative noncorporal punishments with power because it blurs the break between pre-industrial and industrial society, and suggests that pre-industrial freedom was diminished in ways that went far beyond the psychic impact of torture and execution. To the extent that other, far more prevalent punishments suggest that human bodies have always possessed an economic value (to the state, if not the bourgeoisie), they weaken Foucault's assertion that prisons sprang from the advent of capitalist exploitation. Foucault intimates that feudal populations were freer for not being reduced to cogs in a capitalist machine, but pre-industrial penal systems, too, often wrung economic value from convicts.

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The Advent of the Prison

To strengthen the causal relationship between industrialization and the prison, Foucault asserts that France's transition from corporal punishment to prison "occurred almost instantaneously" and "within a short span of time" (115–16). He concedes that the concept of imprisonment goes back as far as 1596 in the Netherlands, and had developed as a form of punishment in eighteenth-century England, but argues that the adoption of imprisonment in France had been slowed by its association with regal tyranny. French hesitation, he argues, was overcome "instantaneously" by two interrelated factors: public sympathy for those executed for crimes against property, and the proliferation of such crimes relative to crimes of physical violence, which curried less public sympathy (62). Both trends coincided with, and are implicitly attributed to, industrialization.

Even a cursory reading of the historical record reveals that Foucault is wrong about both the timing and the speed of the adoption of imprisonment. Prisons were well established long before the Industrial Revolution, and even with industrialization, prisons spread through France not suddenly, but glacially. The first prison sentence was prescribed by English law in 1275: two years imprisonment for rape (Moynahan and Stewart 1980, 13). In medieval England, criminal fines, with imprisonment pending their payment, became a profitable state enterprise (ibid., 46). After 1557, "Bridewell houses" were constructed throughout England, and widely imitated throughout Europe, for imprisoning petty criminals and vagrants and putting them to hard labor (Roberts 1997, 6). At the same time, Germanic countries had begun adopting prisons and prison labor in the sixteenth century as a means of defraying judicial expenses (Melossi 1991, 65). In seventeenth- and eighteenth-century France, 60 percent of convictions resulted in imprisonment or banishment, not death (Ruff 1984, 60). For example, the punishment for most crimes against property was imprisonment—on military galleys as oarsmen for men, and in *maisons de force* for women (ibid., 60, 113–16). In 1690, William Penn made prison the sole means of punishment in Pennsylvania, until the Queen restored English penal law in 1718 (Lewis 1922, 11, 13). When American independence restored prison as the principal form of punishment 50 years later, it was hardly a sudden development, given the Great Law of Pennsylvania a century earlier.

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While the prison's incubation had ended in most states by the end of the eighteenth century, France only came to embrace imprisonment fully in the twentieth century—not the early nineteenth, as Foucault asserts. True, legalized torture ended abruptly between 1780 and 1788, but the debate surrounding prisons raged on for another century. (Wright 1983, 15) It is fair to say that after 1788, only in France was the development of the prison tortured.

After the French revolution, French penology followed a pattern of debate, reform, revolution, and regression. In 1789, the Estates-General enacted a new penal code that would have made prison the primary form of punishment, but the Jacoban Terror of 1794 aborted its implementation, and public executions blossomed as never before (Wright 1983, 31, 34). Napoleon's coup d'état restored order in 1799, and penal reform ensued, but the reforms expanded the death penalty and corporal punishment, and punished lesser crimes with deportation, not imprisonment—which was considered too expensive (ibid., 39–40).

Napoleon's exile and the establishment of the First Republic unleashed an explosion in public debate over the prison. The debate very nearly bore fruit in a plan for the construction of a new prison based on the American Walnut Street model, but this scheme was scuttled by Napoleon's hundred-day return from exile (ibid., 54, 56).

The subsequent restoration of King Louis-Philip saw the resumption of the prison-reform debate, and the slow replacement of deportation by imprisonment. This wave of reform crescendoed in the Assembly's adoption of the American Cherry Hill model prison in 1848 (as advocated by Alexis de Toqueville after his fact-finding mission to the United States) in which prisoners slept and worked in the solitude of their own cells (Wright 1983, 78). Yet again, revolution aborted the reforms, and the new government of the Second Republic began paring back the nascent prison system—consisting of a mere 20 cellular prisons—by eliminating most prison labor (78, 85).

The 1852 coup d'etat by Napoleon II further reversed prison reform, replacing imprisonment—still considered too expensive—with deportation for more serious crimes. (Wright 1983, 92; Perrot 1978, 234). By 1875, only two new prisons had been added to France's total, as the debate between advocates of the prison and advocates of deportation raged on during the Third Republic (Wright 1983, 130).

In 1885, the National Assembly finally succeeded in implementing what King Louis-Philip had attempted 50 years earlier, enacting a law that made prison the primary form of punishment and that mandated

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the construction of a cellular prison system (Wright 1983, 136). Most localities refused to comply with the law, however, diverting monies earmarked for prison construction to deportation and penal colonies (ibid., 138). The largest and most modern cellular prison in Paris was demolished in 1898, in an important symbolic defeat for prison advocates, and 20 years after the law's passage, the number of cellular prisons had only doubled to 41 (ibid.). In fact, deportation was to remain France's primary form of punishment—with roughly 11,000 convicts deported annually—until the 1930s, when prisons finally came into their own (ibid., 138, 150).

The historical record clearly indicates that the French adoption of the prison was anything but instantaneous, and certainly belies Foucault's assertion that the French carceral system was complete on January 22, 1840, with the construction of Mettray (293). Further, the countries that had adopted the prison as their primary means of punishment by the end of the eighteenth century—most notably the United States—did not do so suddenly. The adoption of imprisonment as punishment was everywhere steeped in precedents, from thirteenth-century England to William Penn's Pennsylvania law in 1682.

Foucault times the prison's sudden arrival to coincide with industrialization, the concurrent rise in crimes against property, and the groundswell of popular sympathy for thieves (61–63, 75–77). He enthusiastically recounts how the emergent proletariat came to identify with criminals, elevating them to the status of folk heroes as industrialization drove people from the land and thrust multitudes into poverty (67). The idea is that public torture and execution became a flashpoint for public dissatisfaction and a recipe for proletarian revolution—a risk the emergent bourgeoisie sought to mitigate by cloaking the penal process behind prison walls (77). This notion is culled directly from the traditional Marxist account of the appearance of prisons in France, but this account has been weakened by evidence that most advocates of the prison sprang from the proletariat, not the bourgeoisie (Wright 1983, 20–21). Foucault adroitly circumvents this Marxist shortcoming by shifting the analytical focus from class to capitalism itself.

The fact that the establishment of the prison did not coincide with the Industrial Revolution, but rather stretched over much of the eighteenth and nineteenth centuries, greatly weakens the causal relationship Foucault seeks to establish between industrialization and imprisonment. The pre-industrial use of the prison, and its irregular use within and across countries after the Industrial Revolution, seem consistent with a

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more complex evolution of penology than Foucault provides. For example, the hesitancy of the French in adopting the prison, and their preference for transportation, suggests relatively less interest in discipline than in incapacitation: once transported, convicts seldom returned. Foucault ignores all of this, redacting history as demanded by his theory.

The Prison as Capitalist Mind Control

In the third and most important part of his argument, Foucault considers how the structure of the prison came to reflect the imperatives of power, which were roughly coextensive with the goals of Panopticism. The aim of the prison, Foucault opines, ultimately became the transformation of inmates into compliant, law-abiding, economically productive automatons, reflecting the efficiency demands of emerging market economies (163–64). To this end, prisons came to embody the coercive principles of Jeremy Bentham's Panopticon, as did the school, the hospital, and the factory. Panopticism disciplined its subjects through a program of constant surveillance coupled with strict regimentation according to detailed instructions. Constant surveillance forced subjects to internalize the gaze of authority—enabling them to regulate themselves—while regimentation molded their physical movements to maximize productivity.

Foucault identifies five ways in which prisons incorporated Panopticism. First, cellular isolation forced the inmates into greater self-reflection, pushing them to internalize authority (236). Second, constant surveillance achieved the same end (249–50). Third, remunerated prison labor was adopted as a means of regimenting the habits and movements of inmates, while impressing upon them the centrality of wages as the incentive to work (240, 243). Fourth, flexible prison sentences were meted out, reflecting the requirements of psychological rehabilitation rather than the seriousness of the infraction—though Foucault admits that flexible sentencing was practiced only sporadically (244). The final, similar expression of Panopticism in the prison, Foucault asserts, was the cognitive shift from viewing inmates as "law breakers" to viewing them as "delinquents" (255). Prison administrators regarded their inmates no longer in terms of the crimes they had committed, but rather in terms of their lifelong social pathologies, as reflected by their "biographies." The prisoners were seen as, and made to feel alienated from, society.

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This portion of Foucault's argument is the one that is the most abstracted from reality, and is therefore the most difficult to relate to the historical record; but the actual evolution of the prison during the nineteenth century, and the explicit motivations behind its evolution, seem to diverge markedly from Foucault's account. Industrialization undoubtedly brought an unprecedented awareness of the importance of productivity to economic life, and the emergence of surveillance and hierarchy in schools, factories, and hospitals probably reflected this concern. Foucault is also credible in suggesting that the enhancement of efficiency through discipline initially appeared in the military—where the importance of efficiency was first recognized—long before the Industrial Revolution brought the same concern to other institutions. For this reason, efficiency concerns may have unconsciously undergirded the pronouncements of prison reformers—there is no way of ever verifying their true motivations (Wright 1983, 22). However, the actual extent to which ideas other than Panopticism were reflected in the structure of prisons suggests otherwise.

The lukewarm reception of imprisonment in France was reflected in the disorganized state of the French prison system, which consisted of two levels. Roughly 400 local prisons housed half the prison population, including those waiting for trial and petty criminals serving brief sentences (Wright 1983, 133–34). These squalid facilities were described by shocked prison inspectors as "filled with stupor and horror"; the lack of segregation according to age, sex, or degree of criminality rendered them veritable "crime factories" (ibid., 134). These prisons remained untouched by the philosophical speculation about incarceration, and certainly exhibited no trace of Panopticism—there was no cellular isolation, no work, and no organized surveillance of any kind.

Despite the vigorous political debate surrounding them, France's national prisons—the *maisons centrales*—reflected few Panoptic principles, as their development was stunted by inadequate financial and political support. The first French prison to modestly reflect Panopticism was La Petite Roquette, opened in 1836 to considerable controversy (Wright 1983, 68). Though Roquette adopted prison labor and a rule of silence, it fundamentally diverged from Panopticism in that prisoners slept and worked communally, rather than in cells. Cellular incarceration was to be continuously resisted in France, as too cruel, expensive, and un-French (ibid., 75, 92).

Moreover, prison labor, the linchpin of Panopticism, was implemented unevenly and against great resistance. At first, productive work

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was expected of all inmates, and usually organized by private entrepreneurs, but relentless political pressure from artisans and unions against unfair prison competition ultimately limited the types of goods produced to trifles for public agencies (Wright 1983, 162–64). And high French unemployment after the 1850s often made prison labor less competitive than free labor, further restricting the work available to inmates (Rusche and Kirkheimer 1991, 58–59). Tocqueville himself argued that prison labor was better suited to the United States, where labor was scarce, than to France, where labor was plentiful (ibid., 60).

Apart from solitary confinement and steady work, the Panoptic element most sorely lacking in French prisons was order. Horrible overcrowding, and the use of racketeers to compensate for a shortage of guards, made prison discipline impossible to maintain (Wright 1983, 135). Thus, the prevalence of drunken revelry among prisoners was one of the prime motivations behind King Louis-Philippe's reform efforts in the 1830s (ibid., 69). Charles Lucas, a nineteenth-century French penal scholar, even suggested that the factory prepared the lawbreaker for the rigors of prison labor, not vice versa, as prisons were too undisciplined (Perrot 1978, 230). Thus, the French prison system of the nineteenth century bore little relation to Panopticism: half of it consisted of chaotic local prisons, and the other half imposed little solitary confinement, ineffective surveillance, and no steady work with which to render inmates disciplined, docile bodies.

The American prison system of the early nineteenth century better approximated Panopticism, though the resemblance faded over the course of the century. The actual floor plan of the Panopticon was a crushing failure: the first prison that used Bentham's architecture—Western State Prison, built in 1818 in Pittsburgh—was demolished and rebuilt along more conventional lines 15 years later (Lewis 1922, 118–19). Still, U.S. prisons quickly adopted all the other trappings of Panopticism: rigid discipline, with complete silence imposed through corporal punishment; Orwellian surveillance techniques, such as the "lockstep" and striped uniforms; and solitary confinement in cells by night, with communal work by day (ibid., 17–18). The state-by-state experimentation encouraged by America's federalist system of governance, however, made American prison structure highly variable and dynamic, ultimately resulting in the demise of Panopticism (McKelvey 1968, 28)

The first, post-Revolutionary prison—Walnut Street prison in Philadelphia, built in 1790—incorporated cells for the first time so as

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to prevent the transmission of criminality through fraternization, which was endemic in communal prisons (Lewis 1922, 25). A similar rationale motivated the concurrent elimination of chain gangs: not because they were currying public sympathy, but because they were engaging in lively conversation with young, impressionable boys, who frequently took their lessons to heart (ibid., 17–18). Walnut Street ultimately failed due to overcrowding, which stymied prison labor and revived the disorder cells were supposed to alleviate.

By the 1820s, new prisons opened in Pennsylvania, at Cherry Hill, and in New York, at Auburn, offering different solutions to Walnut Street's perceived shortcomings. The Cherry Hill solitary system prescribed total isolation, with each inmate working and sleeping in the confines of his own cell, only later to be joined by a cellmate as space limitations demanded. Auburn's congregate system opted for communal work by day, with solitary confinement at night. Given the threat of fraternization, prison discipline depended on Draconian enforcement of the "rule of silence," typically by threat of lashings. The Auburn system ultimately prevailed for three reasons: the larger cells required by the Cherry Hill model were too expensive; total isolation was considered inhumane; and Auburn's communal work was more productive and profitable than Cherry Hill's solitary work (Lewis 1922, 132; Roberts 1997, 34, 39). Accordingly, most new U.S. prisons built in the early nineteenth century adopted the Auburn model.

While the Auburn prisons began as a means of disciplining prisoners, their transformation into profit centers by avaricious entrepreneurs and prison administrators quickly unraveled discipline. Prisoners gradually enjoyed more perks in return for higher productivity, and by the 1860s, all but two states had dropped the rule of silence. (McKelvey 1968, 40) The Auburn profit machine was too successful for its own good, however, and protests from unions and companies competing with prison labor resulted in laws greatly constraining, and in some cases forbidding, the use of prison labor for commercial purposes (Roberts 1997, 64; Lewis 1922, 140, 145).

Further, exploitative prison labor, and the brutal enforcement of the rule of silence, galvanized prison reformers in the 1850s, who felt that prisons should serve a more rehabilitative function—a sentiment reflected in a widely publicized poll of prison wardens (McKelvey 1968, 39). To this end, the National Prisons Association—the nation's leading penalogical society—adopted its famous Declaration of Principles in 1870, which advocated the more rigorous segregation of criminals ac-

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cording to age and pathology; rewards and indeterminate sentencing to encourage reformation; and the establishment of prison schools and hospitals (Roberts 1997, 60). The Declaration, coupled with strong religious convictions, inspired the establishment of the Elmira System in 1876 at the Elmira prison in New York (ibid., 63). Gone was corporal punishment, the rule of silence, striped uniforms, the lockstep, and prison labor for profit. In place of naked coercion, Elmira substituted prison schooling, prison labor for vocational training purposes only, rigid segregation—separating prisoners according to three grades of criminality—and extracurricular activities, such as marching bands and athletics (ibid., 64). By 1900, 17 states had adopted the Elmira model, including the Auburn prison itself, and the modern prison had arrived.

What had begun at Auburn as Panopticism ended at Elvira as humanist rehabilitation. Prison labor had shifted its emphasis from discipline to profit, before being snuffed out by disgruntled unions and businesses. The harsh punishment and rigid surveillance required by the rule of silence had been replaced by rewards for good behavior and benevolent career counseling. Panopticism had been repudiated.

Foucault's counterintuitive focus on backward French prisons to the exclusion of the more Panoptic U.S. prisons is itself highly misleading. The United States led the world in penalogical developments throughout the eighteenth and nineteenth centuries, serving as a hotbed of both debate and experimentation (McKelvey 1968, 16, 23). Had Foucault dealt with U.S. penology beyond the Auburn versus Cherry Hill debate carried on in France, he would have had to square his theory of power with a vast array of contradictory developments. French prisons were far less dynamic and varied than those in the United States (though French penalogical debate was just as lively), and thus far easier to squeeze into Foucaultian templates. Even limiting his analysis to France, however, Foucault has to ignore penal reality to focus on Panoptic theories and principles that were debated but never successfully implemented. These omissions are especially glaring given the unconscious motivations Foucault ascribes to prison reformers; such motivations should, at the very least, be reflected in the institutions they purportedly shaped. The fact that they were not is the weakest link in Foucault's four-part historical argument. Accordingly, Foucault's central claim that capitalist efficiency imperatives dictated a Panoptic prison structure unravels when confronted by the reality of nineteenth-century prisons in America and France.

Foucault's focus on Panopticism obscures the visible forces driving

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the nineteenth-century development of prisons, which had more to do with trial and error, expediency, and the work of impassioned reformers than with a desire to mold passive proletarians. Capitalism was far from the minds of the Quakers who founded the first modern prison at Walnut Street. Rather, Walnut Street was conceived as the very embodiment of Quaker values, with solitary confinement encouraging introspection, labor forging good habits, and religious instruction facilitating spiritual growth. Within 20 years, however, the prison was in shambles, as overcrowding had unraveled solitary confinement, work, and discipline. Western State Prison, which did indeed test Bentham's Panopticon, was an even more spectacular failure. Cherry Hill fared little better, as the relentless cellular isolation reportedly drove prisoners mad.

The shortcomings of imprisonment were even more pronounced in France. Deportation was the preferred punishment: a cheaper, more effective attack on recidivism (and one that advanced French imperialism) than prisons, which were largely overcrowded, communal, and undisciplined. Prison labor was initially embraced, only to disintegrate with rising French unemployment. Numerous attempts at prison reform were thwarted by an endless succession of social upheavals.

Panopticism achieved brief success in America with the congregate system begun at Auburn, but it contained the seeds of its own destruction. The system's heavy-handed discipline, coupled with its blatant exploitation of prison labor, drew fire from the national press and from prominent religious figures such as Louis Dwight. The crusade for replacing prison labor with rehabilitation, spearheaded by a coalition of the National Prison Association, self-interested unions and businesses, and penal crusaders, ultimately spawned the Elmira System of vocational training in a congenial environment.

How the overarching imperatives of a capitalist economy—as opposed to the income of particular capitalists—could have been served by Auburn's dysfunctional brand of Panopticism is far from obvious. Perhaps these prisons initially strove to discipline their inmates through a combination of cellular isolation, silence, and work; but all too quickly, prison labor became a route to profit, not rehabilitation. In 1852, nine Auburn-style prisons reported a massive combined profit of $23,000 (McKelvey 1968, 40). The profit motive was even more explicit in the South, where poorer states washed their hands of prisoners entirely, leasing them to private factories and farms that housed them under atrocious conditions (Roberts 1997, 51). In this way, American prisons served the marketplace far more directly than Panopticism, but

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without touching the prisoners' souls so as to make them efficient workers. Greed and administrative expediency had effectively trumped the high-minded words of Bentham, Eddy (father of the Auburn system), Montesquieu, and Beccaria.

If the state prison sector evolved slowly in the United States, and glacially in France, the local prison system was a shambles in both countries (Wright 1983, 134; McKelvey 1968, 20). There, petty criminals serving short sentences were herded into communal cells with the bare minimum of heat, comfort, and food, and often without regard for guilt or innocence, age, or gender (McKelvey 1968, 35). There was no work, no recreation, and more importantly, no method whatsoever, just punishment and incapacitation.

Foucault's insistence that Panopticism was the leitmotif of nineteenth-century imprisonment is belied at every turn, then, by the historical record. Most glaringly, the French state penal system on which he chooses to focus was far less Panoptic than its American counterpart. Transportation, not prison, was the preferred punishment in France. The actual French prison system was largely communal, undisciplined, and sedentary. And the American prisons that Foucault neglects developed away from, not towards, Panopticism.

The Prison's Convenient Failure

After recounting his dubious history of the prison, Foucault reveals that incarceration failed to achieve its lofty aspirations, failing to reduce crime, increasing recidivism, intensifying popular resentment against the system of justice, and spawning a community of irredeemable delinquents (265–68). He deftly recharacterizes this failure, however, as an integral part of the unconscious capitalist plot. Foucault explains that by transforming criminals into delinquents, thereby branding them as bad people, prisons generated useful deviants and helped increase the gulf between law-abiding citizens and lawbreakers. For want of gainful employment, the newly created deviants were pressed into service by the bourgeoisie, running brothels, casinos, and other criminal enterprises; spying on the proletariat; and justifying employment in the carceral system (277, 285).

The "useful delinquency" argument fundamentally fails by mischaracterizing recidivism as the result of prison reform, rather than as its catalyst. For example, high recidivism rates spurred the adoption of

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transportation in France and the Auburn system in America. As the Auburn system self-destructed, the Elmira system was proposed as a superior means of transforming prisoners into law-abiding citizens, thereby reducing recidivism. Post-release guidance counselors and small payments were provided in several American jurisdictions to facilitate the reintegration of ex-cons into the workforce (McKelvey 1968, 43). By ignoring the dynamic, heterogeneous nature of penalogical development in favor of a monodimensional theory, Foucault mistakes cause for effect.

The useful delinquency argument also fails on its own terms. History suggests that bourgeois citizens continued to show concern for prisoners, delinquency or no. Beginning in the late eighteenth century, American Quakers began visiting prisons to ensure humane conditions, and they tried to help rehabilitate convicts through such organizations as the Philadelphia Society for Alleviation of the Miseries of Public Prisons (Lewis 1922, 13, 28). In France, analogous organizations of aristocrats monitored prison conditions and fought for their improvement (Wright 1983, 14, 56). Throughout the nineteenth century, numerous prison-reform gadflies in the United States and Europe succeeded in galvanizing public indignation over appalling prison conditions, often yielding substantial results. Even apart from single-minded reform advocates, at least one historian (Melossi 1991, 71) opines that most nineteenth-century civil protests held in England and America were intended to improve prisons, and that the storming of the Bastille had as much to do with anger over mean prison conditions as with any desire to overthrow the monarchy.

Nor was tolerance for criminality as class-specific as Foucault suggests. There was no pocket of tolerated bourgeois illegality such as gambling that benefited from a willing pool of delinquents who were barred from gainful employment by their prison records (279). Indeed, the most important new criminal laws to emerge in nineteenth-century France came at the expense of the bourgeoisie, as white-collar crime was increasingly penalized (Wright 1983, 220). So-called "crimes of cunning" were increasingly recognized and prosecuted in the 1860s, and "the depraved crook of the industrialized areas" was officially deemed more contemptible than the "illiterate inhabitant of [the] Southern provinces who . . . kills his adversary in a fight" (ibid., 224–25, quoting *Compte*, France's crime statistics annual).

Foucault's related charge that employees of the justice system advanced their own institutional interests by encouraging recidivism is

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made less convincing by the fact that elected officials and advocates from outside the penal system ultimately determined penal law and the structure of prisons. For example, transportation in France, and the Elvira system in America, were long-term strategies to combat recidivism that arguably reduced employment in the penal system, and at least replaced old employees with new ones. The rapidly changing penal environment throughout the nineteenth century suggests that penal employees were not very adept at protecting their jobs by maintaining the status quo.

Foucault's deviancy argument puts a positive spin on the prison's seeming failure as a disciplinary device. Describing this failure in dry statistical terms (265–68). Foucault manages to obscure the real reason prisons failed to produce self-disciplined workers: namely, that they failed to adopt Panopticism or any other policy that could have reduced inmates to mindless cogs in the capitalist machine. Cut loose from real historical moorings, Foucault's deviancy argument overlooks the possibility that recidivism and undiminished crime rates were catalysts for further prison reform, not bourgeois rationales for perpetuating a malfunctioning Panoptic juggernaut.

* * *

By systematically butchering the history of the prison, Foucault is able to forge the four links in his argumentative chain. First, public torture and execution served as operant conditioning in disorganized, pre-industrial societies. Second, prisons instantaneously materialized as industrialization brought a surge both in theft and in public sympathy for thieves born of a growing class awareness. Third, Panopticism permeated prisons—as well as schools, factories, and hospitals—as a means of fashioning the mindless automatons required by an efficient capitalist economy. Fourth, recidivism made criminals widely reviled and economically useful.

While Foucault's history of the prison neatly tracks his conception of penology as capitalist conspiracy, it diverges markedly from the historical record. Public torture and execution were not nearly as prevalent as Foucault suggests; they were common enough to publicize the punishment for certain crimes, but not so common as to cow citizens in the face of the sovereign's limitless power. Nor did prisons appear suddenly: imprisonment was intermittently utilized in various guises for centuries prior to 1840, and France was especially slow in adopting it. Panopticism was the exception, not the rule, only briefly implemented in

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American prisons in the first half of the nineteenth century. Recidivism, far from being tacitly encouraged, was constantly attacked by changes in penal strategy.

A more complete history of the prison suggests that many forces beyond "power" were at work. Economic and bureaucratic shortcomings played a prominent role in the development of French prisons, and certainly rendered Panoptic discipline and punishment a practical impossibility for most convicts. Humanitarian and religious convictions played a prominent role in the evolution of the American prison, as did federalist experimentation. More generally, industrialization did not force the modalities of power into the shadows—shifting from a visible dominion over the body to an insidious influence on the soul—but, rather, forced them into the light as never before. The political revolutions that accompanied the Industrial Revolution forced governments to justify penology on utilitarian grounds, which were constantly subject to public debate and state experimentation. While the disciplinary requirements of capitalism were undoubtedly factored into penal debate, and were sometimes incorporated into prisons themselves, they were not always decisive, and often lost out to the competing values of fairness, compassion, and pragmatism.

Foucault denies any allegiance to Marxism and rejects class or proletarian revolution. Yet it should not be forgotten that the tale he tells in *Discipline and Punish* is a tale of the triumphant imposition of false consciousness by capitalist "power." Nor should it be forgotten that this tale is, in virtually every major detail, wrong.

NOTES

1. Foucault disparaged Karl Marx as an extension of David Ricardo, and Marxism as a theory that "can only breathe in a positivist pond" (Sarup 1989, 78). He found Marxists too eager to transform Marxism into a science, where science is merely a fiction wielded to reify the distopian status quo (ibid., 77, 88). More fundamentally, Foucault felt Marxists were too class-obsessed, arguing that the true source of oppression is "power," which transcends class. The fact that power operates above the state makes proletarian revolution futile, as its ill effects would be undiminished by a change in government (ibid., 86).

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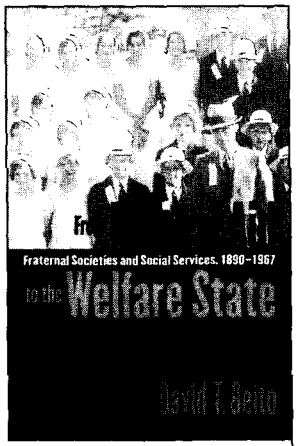

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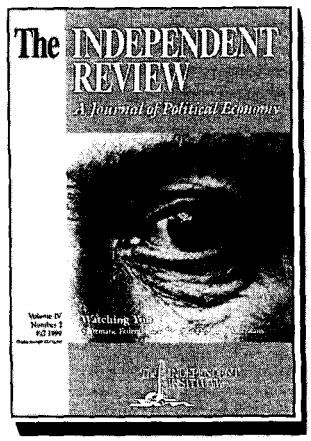

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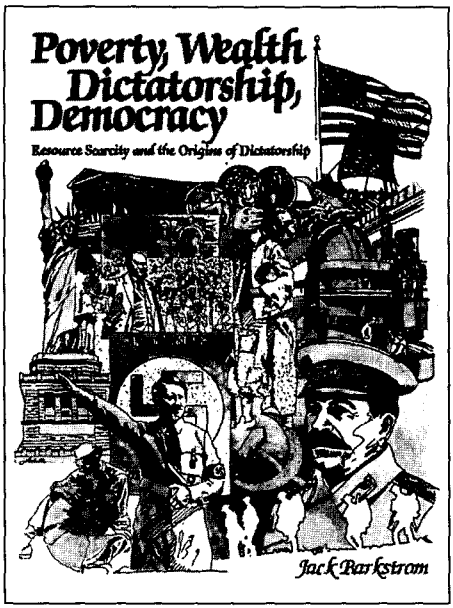

The experimental variable... Communism has long been considered the key to any understanding of the Soviet Union. Communism, it was believed, is the experimental variable which explains the failures of the "economic experiment" which the Soviet Union became.

Changing the variable in any experiment is expected to change the results, if the variable has been correctly identified. The elimination of communism in the Soviet Union did change the experimental outcome, but not in the way predicted. Rather than a miraculous turnaround, the Russian economy has experienced a downward spiral. Market advocates have offered excuses rather than explanations – Russian political leadership is weak or market reforms have not been carried out. The problem may be that communism has been incorrectly identified as the experimental variable responsible for Russia's problems. Resource availability may prove to be more reliable, as a variable. Russia is a poor country and poor economic performance may be better explained by poverty than by bad governmental policy.

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